FEDERAL RECEIPTS AND COLLECTIONS

4. FEDERAL RECEIPTS

Receipts (budget and off-budget) are taxes and other collections from the public that result from the exercise of the Federal Government's sovereign or governmental powers. The difference between receipts and outlays determines the surplus or deficit.

The Federal Government also collects income from the public from market-oriented activities. Collections from these activities, which are subtracted from gross outlays, rather than added to taxes and other governmental receipts, are discussed in the following chapter.

Growth in receipts.—Total receipts in 2004 are estimated to be $1922.0 billion, an increase of $85.8 billion or 4.7 percent relative to 2003. Receipts are projected to grow at an average annual rate of 7.0 percent between 2004 and 2008, rising to $2,520.9 billion. This growth in receipts is largely due to assumed increases in incomes resulting from both real economic growth and inflation. These estimates reflect an adjustment for revenue uncertainty of -$25 billion in 2003 and -$15 billion in 2004. As this description suggests, these latter amounts reflect an additional adjustment to receipts beyond what the economic and tax models forecast and have been made in the interest of cautious and prudent forecasting.

As a share of GDP, receipts are projected to decline from 17.9 percent in 2002 to 17.1 percent in 2003 and 17.0 percent in 2004. The receipts share of GDP is projected to increase annually thereafter, rising to 18.3 percent in 2008.

Table 4–1. RECEIPTS BY SOURCE—SUMMARY

(In billions of dollars)

Source	2002 actual	Estimate					
		2003	2004	2005	2006	2007	2008
Individual income taxes	858.3	849.1	849.9	934.6	1,014.1	1,103.4	1,175.3
Corporation income taxes	148.0	143.2	169.1	229.3	233.8	237.8	243.7
Social insurance and retirement receipts	700.8	726.6	764.5	810.9	845.8	883.6	922.2
(On-budget)	(185.4)	(195.0)	(208.4)	(221.4)	(231.0)	(239.1)	(249.0)
(Off-budget)	(515.3)	(531.6)	(556.2)	(589.5)	(614.8)	(644.4)	(673.2)
Excise taxes	67.0	68.4	70.9	73.3	75.6	77.8	80.0
Estate and gift taxes	26.5	20.2	23.4	21.1	23.2	20.8	21.2
Customs duties	18.6	19.1	20.7	21.2	23.9	26.0	27.6
Miscellaneous receipts	33.9	34.7	38.5	44.8	46.9	48.8	51.0
Adjustment for revenue uncertainty	......	–25.0	–15.0	......	......	......	......
Total receipts	**1,853.2**	**1,836.2**	**1,922.0**	**2,135.2**	**2,263.2**	**2,398.1**	**2,520.9**
(On-budget)	*(1,337.9)*	*(1,304.7)*	*(1,365.9)*	*(1,545.7)*	*(1,648.4)*	*(1,753.6)*	*(1,847.7)*
(Off-budget)	*(515.3)*	*(531.6)*	*(556.2)*	*(589.5)*	*(614.8)*	*(644.4)*	*(673.2)*

Table 4–2. EFFECT ON RECEIPTS OF CHANGES IN THE SOCIAL SECURITY TAXABLE EARNINGS BASE

(In billions of dollars)

	Estimate				
	2004	2005	2006	2007	2008
Social security (OASDI) taxable earnings base increases:.					
$87,000 to $88,200 on Jan. 1, 2004	0.5	1.4	1.6	1.7	1.9
$88,200 to $92,100 on Jan. 1, 2005	......	1.8	4.8	5.3	5.8
$92,100 to $96,000 on Jan. 1, 2006	......	......	1.8	4.8	5.3
$96,000 to $99,900 on Jan. 1, 2007	......	......	......	1.8	4.8
$99,900 to $103,500 on Jan. 1, 2008	......	......	......	......	1.7

ENACTED LEGISLATION

Several laws were enacted in 2002 that have an effect on governmental receipts. The major legislative changes affecting receipts are described below.

JOB CREATION AND WORKER ASSISTANCE ACT OF 2002 (JCWAA)

In the fall of 2001, President Bush called on the Congress to enact an economic security bill designed to reinvigorate economic growth and assist workers affected by the economic downturn that followed the terrorist attacks of September 11, 2001. The Congress responded in early 2002 and on March 9 President Bush signed the Job Creation and Worker Assistance Act of 2002. In addition to providing increased spending for extended unemployment benefits and funding for the Temporary Assistance for Needy Families supplemental grant program, this Act provides tax incentives to encourage business investment, provides tax incentives to help an area of New York City referred to as the Liberty Zone recover from the September 11th terrorist attacks, and extends a number of tax incentives that had expired or were scheduled to expire. The major provisions of the Act that affect receipts are described below.

Business Tax Relief

Provide a special depreciation allowance for certain property.—Taypayers are allowed to recover the cost of certain property used in a trade or business or for the production of income through annual depreciation deductions. The amount of the allowable depreciation deduction for a taxable year is generally determined under the modified accelerated cost recovery system, which assigns applicable recovery periods and depreciation methods to different types of property.

Effective for qualifying assets acquired after September 10, 2001 (a binding written contract for purchase must not have been in effect before September 11, 2001) and before September 11, 2004, this Act allows an additional first-year depreciation deduction equal to 30 percent of the adjusted basis of the property. The additional first-year depreciation deduction is allowed for both regular and alternative minimum tax purposes in the year the property is placed in service. The basis of the property and the depreciation deductions allowable in other years are adjusted to reflect the additional first-year depreciation deduction. Qualifying property includes tangible property with depreciation recovery periods of 20 years or less, certain software, water utility property, and qualified leasehold improvements. To qualify for the special depreciation allowance, the original use of the property must commence with the taxpayer after September 10, 2001 (except for certain sale-leaseback property) and the property must be placed in service before January 1, 2005 (January 1, 2006 for certain longer production period property). In addition, the limitation on first-year allowable depreciation for certain automobiles is increased by $4,600.

Allow five-year carryback of net operating losses.—A net operating loss (NOL) generally is the amount by which a taxpayer's allowable deductions exceed the taxpayer's gross income. A carryback of an NOL generally results in a refund of Federal income taxes paid for the carryback year. A carryforward of an NOL generally reduces Federal income tax payments for the carryforward year. Under prior law, an NOL generally could be carried back two years and carried forward 20 years; however, NOL deductions could not reduce a taxpayer's alternative minimum taxable income (AMTI) by more than 90 percent.

For NOLs arising in taxable years ending in 2001 and 2002, this Act generally extends the carryback period to five years. In addition, this Act allows NOL deductions attributable to NOL carrybacks arising in taxable years ending in 2001 and 2002, as well as NOL carryforwards to these taxable years, to offset 100 percent of a taxpayer's AMTI.

Unemployment Assistance

Allow special Reed Act transfers.—The Federal Unemployment Tax (FUTA) paid by employers funds the administrative costs of the unemployment insurance system and related programs. State unemployment taxes are deposited into the Unemployment Trust Fund and used by States to pay unemployment benefits. Under current law, FUTA balances in excess of statutory ceilings are distributed to the States to pay unemployment benefits or the administrative costs of the system (these are known as Reed Act distributions). However, the Balanced Budget Act of 1997 limited Reed Act transfers to states to $100 million after each of fiscal years 1999, 2000, and 2001, and limited the use of these $100 million distributions to paying administrative expenses of unemployment compensation laws.

Under JCWAA the $100 million limit on distributions from excess federal funds available at the end of fiscal year 2001, as well as the limitation on the use of the distributions, are repealed. This allows the Secretary of the Treasury to transfer excess FUTA balances as of the close of fiscal year 2001 into the account of each State in the Unemployment Trust Fund. Total transfers are capped at $8 billion.

Tax Benefits for the New York Liberty Zone

Expand eligibility for the work opportunity tax credit.—This Act temporarily expands eligibility for the work opportunity tax credit to include: (1) employees who perform substantially all of their services in the New York Liberty Zone (a specified area of downtown Manhattan surrounding the site of the World Trade Center) for a business located in the New York Liberty Zone, and (2) employees who perform substantially all their services in New York City for a business that relocated from the New York Liberty Zone to elsewhere in New York City as a result of the events of September 11, 2001. The credit is available for wages paid or incurred for work performed by eligible individuals after December 31, 2001 and before January 1, 2004, and applies to wages paid to both new hires and existing employees. In addition, the portion of each employer's work opportunity tax credit attributable to this new targeted group of employees is allowed against the alternative minimum tax (AMT).

Provide a special depreciation allowance to certain property.—Under this Act, certain qualifying assets used in the New York Liberty Zone are eligible for an additional first-year depreciation deduction equal to 30 percent of the adjusted basis of the property. The additional first-year depreciation deduction is allowed for both regular and alternative minimum tax purposes in the year the property is placed in service. The basis of the property and the depreciation deductions allowable in other years are adjusted to reflect the additional first-year depreciation deduction. Qualifying assets include tangible property with depreciation recovery periods of 20 years or less, certain software, water utility property, and certain real property. Nonresidential real property and residential rental property are eligible for the special depreciation deduction only to the extent such property rehabilitates real property damaged, or replaces real property destroyed or condemned, as a result of the terrorist attacks of September 11, 2001. Assets qualifying for the additional first-year depreciation allowance (described above under Business Tax Relief) and qualified New York Liberty Zone leasehold improvement property are not eligible for the New York Liberty Zone special depreciation allowance. To qualify for the special depreciation allowance, substantially all of the use of the property must be in the New York Liberty Zone, the original use of the property in the New York Liberty Zone must commence with the taxpayer after September 10, 2001 (except for certain sale-leaseback property), the taxpayer must acquire the property by purchase after September 10, 2001, a binding written contract for purchase of the property must not have been in effect before September 11, 2001, and the property must be placed in service on or before December 31, 2006 (December 31, 2009 for nonresidential real property and residential rental property).

Authorize issuance of tax-exempt private activity bonds.—Interest on bonds issued by state and local governments to finance activities carried out and paid for by private persons (private activity bonds) is taxable unless the activities are specified in the Internal Revenue Code. The volume of certain tax-exempt private activity bonds that state and local governments may issue in each calendar year is limited by state-wide volume limits. Under this Act, an aggregate of $8 billion of tax-exempt private activity bonds may be issued during calendar years 2002, 2003 and 2004 for the acquisition, construction, reconstruction and renovation of nonresidential real property, residential rental property, and public utility property in the New York City Liberty Zone. Projects for which the bonds may be issued are limited to those approved by the Mayor of New York City or the Governor of New York State, each of whom may designate up to $4 billion of the bonds. In addition, each of those officials may designate up to $1 billion of the bonds to be used for the acquisition, construction, reconstruction and renovation of commercial real property located outside the Zone and within New York City, provided the property meets specified criteria. These bonds are not subject to the aggregate annual state private activity bond volume limit; several additional exceptions and modifications to the general rules applicable to the issuance of exempt-facility private activity bonds also apply.

Allow one additional advance refunding for certain previously refunded bonds.—Refunding bonds are used to redeem previously issued bonds. Different rules apply to "current" and "advance" refunding bonds. A current refunding occurs when the refunded debt is retired within 90 days of issuance of the refunding bonds. Tax-exempt bonds may be currently refunded an indefinite number of times. An advance refunding occurs when the refunded debt is not retired within 90 days after the refunding bonds are issued; instead, the proceeds of the refunding bonds are invested in an escrow account and held until a future date when the refunded debt may be retired. In general, governmental bonds and tax-exempt private activity bonds for charitable organizations (qualified 501 (c)(3) bonds) may be advance refunded one time.

This Act permits certain bonds for facilities located in New York City to be advance refunded one additional time. Eligible bonds include only those bonds for which all present-law advance refunding authority was exhausted before September 12, 2001, and with respect to which the advance refunding bonds authorized under present law were outstanding on September 11, 2001. In addition, at least 90 percent of the net proceeds of the refunded bonds must have been used to finance facilities located in New York City and the bonds must be: (1) governmental general obligation bonds of New York City; (2) governmental bonds issued by the Metropolitan Transportation Authority of the State of New York; (3) governmental bonds issued by the New York City Municipal Water Finance Authority; or (4) qualified 501 (c)(3) bonds issued by or on behalf of New York State or New York City to finance hospital facilities. The maximum aggregate amount of advance refunding bonds that may be issued in calendar years 2002, 2003, and 2004 is $9 billion. Eligible advance refunding bonds must be designated by the Mayor of New York City or the Governor of New York State, each of whom may designate up to $4.5 billion of the bonds.

Increase expensing for certain business property.—In lieu of depreciation, taxpayers with a sufficiently small amount of annual investment (those that annually invest less than $200,000) generally may elect to deduct up to $24,000 ($25,000 for taxable years beginning after 2002) of the cost of qualifying property placed in service during the taxable year. Effective for certain qualifying capital assets acquired and placed in service after September 10, 2001 and before January 1, 2007, this Act increases the amount that may be deducted by such businesses to the lesser of $35,000 or the cost of the qualifying property. For property to qualify for the increased expensing: (1) substantially all of the use of the property must be in the New York Liberty Zone in the active conduct of a trade or business located in the Liberty Zone, and (2) the original use of the property in the Liberty Zone must commence with the taxpayer after September 10, 2001.

Extend replacement period for certain involuntarily converted property.—A taxpayer generally may elect not to recognize gain on property that is involuntarily converted if property similar or related in service or use is acquired within a designated replacement period. In general, the replacement period begins with the date of the disposition of the converted property and ends two years after the close of the first taxable year in which any part of the gain upon conversion is realized. The replacement period is extended to three years if the converted property is real property held for productive use in a trade or business, or for investment. This Act extends the replacement period to five years for property involuntarily converted within the New York Liberty Zone as a result of the terrorist attacks of September 11, 2001, if substantially all of the use of the replacement property is in New York City.

Modify treatment of qualified leasehold improvement property.—The depreciation deduction allowed for improvements made on leased property is determined under the modified accelerated cost recovery system, even if the recovery period assigned to the property is longer than the term of the lease. Leasehold improvements are depreciated using the straight-line method and a recovery period that corresponds to the type of real property being improved (39 years in the case of nonresidential real property). Under this Act, qualified leasehold improvement property placed in service in the New York Liberty Zone after September 10, 2001 and before January 1, 2007, and which is not subject to a written binding contract in effect before September 11, 2001, is to be depreciated over five years using the straight-line method. The alternative depreciation system recovery period for such property is nine years under this Act. Qualified New York City Liberty Zone leasehold improvement property is not eligible for the special depreciation allowance available to qualified New York Liberty Zone property or the special first-year depreciation allowance created by this Act and described above under Business Tax Relief.

Miscellaneous and Technical Provisions

Modify interest rate used in determining additional required contributions to defined benefit plans and Pension Benefit Guaranty Corporation (PBGC) variable rate premiums.—Minimum and maximum funding requirements are imposed on defined benefit pension plans under current law. Minimum funding requirements generally are the amount needed to fund benefits earned during the year, plus the year's portion of the amortized cost of other liabilities. If a defined benefit plan is underfunded under a statutorily specified calculation, additional contributions are required. The PBGC also insures the benefits owed under defined benefit pension plans, requiring that employers pay premiums to the PBGC for this insurance coverage. If a plan is underfunded, additional premiums (referred to as variable rate premiums), based on the amount of unfunded vested benefits, are required. This Act expands the permissible range of the statutory interest rate used in calculating whether a defined benefit pension plan is underfunded, thereby affecting both the need for an employer to make additional contributions to a plan and the amount of those additional contributions. This Act also increases the interest rate used to determine the amount of unfunded vested benefits, thereby affecting the amount of variable rate premiums imposed. These interest rate changes are effective for plan years beginning after December 31, 2001 and before January 1, 2004.

Allow teachers to deduct out-of-pocket classroom expenses.—Under a permanent provision employees who incur unreimbursed, job-related expenses are allowed to deduct those expenses to the extent that when combined with other miscellaneous itemized deductions they exceeded 2 percent of adjusted gross income (AGI), but only if the taxpayer itemizes deductions (i.e., does not use the standard deduction). Effective for expenses incurred in taxable years beginning after December 31, 2001 and before January 1, 2004, this Act allows certain teachers and other elementary and secondary school professionals to treat up to $250 in qualified out-of-pocket classroom expenses as a non-itemized deduction (above-the-line deduction). Unreimbursed expenditures for certain books, supplies and equipment related to classroom instruction qualify for the deduction.

Modify other tax provisions.—This Act also makes technical corrections to previously enacted legislation, removes the statutory impediment to providing copies of specified information returns to taxpayers electronically, expands the exclusion from income for qualified foster care payments, limits the use of the non-accrual experience method of accounting to the amount to be received for the performance of qualified professional services, and prohibits shareholders from increasing the basis of their stock in an S corporation by their pro rata share of income from the discharge of indebtedness of the S corporation that is excluded from the S corporation's income.

Expired or Expiring Provisions

Extend alternative minimum tax relief for individuals.—A temporary provision of prior law, which had permitted nonrefundable personal tax credits to offset both the regular tax and the alternative minimum tax (AMT), had expired for taxable years beginning after December 31, 2001. This Act extends minimum tax relief for nonrefundable personal tax credits two years, to apply to taxable years 2002 and 2003. The extension does not apply to the child credit, the earned income tax credit or the adoption credit, which were provided AMT relief through December 31, 2010 under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). The refundable portion of the child credit and the earned income tax credit are also allowed against the AMT through December 31, 2010.

Extend the work opportunity tax credit.—The work opportunity tax credit provides an incentive for employers to hire individuals from certain targeted groups. The credit generally applies to the first $6,000 of wages paid to several categories of economically disadvantaged or handicapped workers. The credit rate is 25 percent of qualified wages for employment of at least 120 hours but less than 400 hours and 40 percent for employment of 400 or more hours. This Act extends the credit, which had expired with respect to workers hired after December 31, 2001, making it available for workers hired before January 1, 2004.

Extend the welfare-to-work tax credit.—The welfare-to-work tax credit entitles employers to claim a tax credit for hiring certain recipients of long-term family assistance. The purpose of the credit is to expand job opportunities for persons making the transition from welfare to work. The credit is 35 percent of the first $10,000 of eligible wages in the first year of employment and 50 percent of the first $10,000 of eligible wages in the second year of employment. Eligible wages include cash wages plus the cash value of certain employer-paid health, dependent care, and educational fringe benefits. The minimum employment period that employees must work before employers can claim the credit is 400 hours. This Act extends the credit, which had expired with respect to individuals who began work after December 31, 2001, to apply to individuals who begin work before January 1, 2004.

Extend Archer Medical Savings Accounts (MSAs)—Self-employed individuals and employees of small firms are allowed to establish Archer MSAs; the number of accounts is capped at 750,000. In addition to other requirements, (1) individuals who establish Archer MSAs must be covered by a high-deductible health plan (and no other plan) with a deductible of at least $1,700 but not greater than $2,500 for policies covering a single person and a deductible of at least $3,350 but not greater than $5,050 in all other cases, (2) tax-preferred contributions are limited to 65 percent of the deductible for single policies and 75 percent of the deductible for other policies, and (3) either an individual or an employer, but not both, may make a tax-preferred contribution to an Archer MSA for a particular year. This Act extends the Archer MSA program, which was scheduled to expire on December 31, 2002, through December 31, 2003.

Extend tax on failure to comply with mental health parity requirements applicable to group health plans.—Under prior law, group heath plans that provided both medical and surgical benefits and mental health benefits, could not impose aggregate lifetime or annual dollar limits on mental health benefits that were not imposed on substantially all medical and surgical benefits. An excise tax of $100 per day (during the period of noncompliance) was imposed on an employer sponsoring a group plan that failed to meet these requirements. For a given taxable year, the tax was limited to the lesser of 10 percent of the employer's group health insurance expenses for the prior taxable year or $500,000. The excise tax was applicable to plan years beginning on or after January 1, 1998 and expired with respect to benefits for services provided on or after December 31, 2002. This Act extends the excise tax to apply to benefits for services provided before January 1, 2004.

Extend tax credit for purchase of electric vehicles.—Under prior law, a 10-percent tax credit up to a maximum of $4,000 was provided for the cost of a qualified electric vehicle. The full amount of the credit was available for purchases prior to January 1, 2002. The credit began to phase down in 2002 and was not available for purchases after 2004. This Act defers the phasedown of the credit for two years. The full amount of the credit is available for purchases in 2002 and 2003, but begins to phase down in 2004; the credit is not available for purchases after December 31, 2006.

Extend deduction for qualified clean-fuel vehicles and qualified clean-fuel vehicle refueling property.—Under prior law, certain costs of acquiring clean-fuel vehicles (vehicles that use certain clean-burning fuels) and property used to store or dispense clean-burning fuel, could be expensed and deducted when the property was placed in service. For qualified clean-fuel vehicles, the maximum allowable deduction was $50,000 for a truck or van with a gross vehicle weight over 26,000 pounds, or a bus with seating capacity of at least 20 adults; $5,000 for a truck or van with a gross vehicle weight between 10,000 and 26,000 pounds; and $2,000 in the case of any other motor vehicle. The full amount of the deduction could be claimed for vehicles placed in service before January 1, 2002, but began to phase down for vehicles placed in service after December 31, 2001, and was not available after December 31, 2004. For qualified property used to store or dispense clean-burning fuel, or used to recharge electric vehicles, the owner was allowed to deduct up to $100,000 of the cost of the property at each location, provided the property was placed in service before January 1, 2005. This Act defers the phasedown of the deduction for clean-fuel vehicles by two years. The full amount of the deduction is available for vehicles placed in service in 2002 and 2003, begins to phase down in 2004, and is unavailable after December 31, 2006. The provision extends the placed-in-service date for clean-fuel vehicle refueling property by two years, making the deduction available for property placed in service prior to January 1, 2007.

Extend tax credit for producing electricity from certain sources.—Under prior law, taxpayers were provided a 1.5-cent-per-kilowatt-hour tax credit, adjusted for inflation after 1992, for electricity produced from wind, closed-loop biomass (organic material from a plant grown exclusively for use at a qualified facility to produce electricity), and poultry waste. To qualify for the credit, the electricity had be sold to an unrelated third party and had be produced during the first 10 years of production at a facility placed in service before January 1, 2002. This Act extends the credit to apply to electricity produced at a facility placed in service before January 1, 2004.

Extend suspension of net income limitation on percentage depletion from marginal oil and gas wells.—Taxpayers are allowed to recover their investment in oil and gas wells through depletion deductions. For certain properties, deductions may be determined using the percentage depletion method; however, in any year, the amount deducted generally may not exceed 100 percent of the net income from the property. Under prior law, for taxable years beginning after December 31, 1997 and before January 1, 2002, domestic oil and gas production from "marginal" properties was exempt from the 100-percent of net income limitation. This Act extends the exemption to apply to taxable years beginning after December 31, 2001 and before January 1, 2004.

Repeal requirement that registered motor fuels terminals offer dyed fuel as a condition of registration.—With limited exceptions, excise taxes are imposed on all highway motor fuels when they are removed from a registered terminal facility, unless the fuel is indelibly dyed and is destined for a nontaxable use. Terminal facilities are not permitted to receive and store non-tax-paid motor fuels unless they are registered with the Internal Revenue Service (IRS). Effective January 1, 2002, in order to be registered under prior law, a terminal had to offer for sale both dyed and undyed fuel (the "dyed-fuel mandate"). This Act repeals the dyed-fuel mandate effective January 1, 2002.

Extend authority to issue Qualified Zone Academy Bonds.—Prior law allowed state and local governments to issue "qualified zone academy bonds," the interest on which was effectively paid by the Federal government in the form of an annual income tax credit. The proceeds of the bonds had to be used for teacher training, purchases of equipment, curriculum development, or rehabilitation and repairs at certain public school facilities. A nationwide total of $400 million of qualified zone academy bonds were authorized to be issued in each of calendar years 1998 through 2001. In addition, unused authority arising in 1998 and 1999 could be carried forward for up to three years and unused authority arising in 2000 and 2001 could be carried forward for up to two years. This Act authorizes the issuance of an additional $400 million of qualified zone academy bonds in each of calendar years 2002 and 2003.

Extend tax incentives for employment and investment on Indian reservations.—This Act extends for one year, through December 31, 2004, the employment tax credit for qualified workers employed on an Indian reservation and the accelerated depreciation rules for qualified property used in the active conduct of a trade or business within an Indian reservation.

For a given taxable year, the employment tax credit is equal to 20 percent of the amount by which qualified wages and health insurance costs paid by an employer exceed the amount paid by the employer in 1993. The amount of qualified wages and health insurance costs taken into account with respect to any employee for any taxable year may not exceed $20,000. A qualified employee is an individual who is an enrolled member of an Indian tribe (or is the spouse of an enrolled member), lives on or near the reservation where he or she works, performs services that are all or substantially all within the Indian reservation, and receives wages from the employer that are less than or equal to $30,000 (adjusted annually for inflation after 1994) when determined at an annual rate. The employment tax credit is not available for employees involved in certain gaming activities or who work in a building that houses certain gaming activities.

The accelerated depreciation recovery periods for qualified Indian reservation property are: 2 years for 3-year property, 3 years for 5-year property, 4 years for 7-year property, 6 years for 10-year property, 9 years for 15-year property, 12 years for 20-year property, and 22 years for nonresidential real property. Qualifying property must be used predominantly in the active conduct of a trade or business within an Indian reservation, cannot be used outside the reservation on a regular basis (except for qualified infrastructure property if the purpose of such property is to connect with qualified infrastructure property located within the reservation), and cannot be acquired from a related person. Property used to conduct or house certain gaming activities is not eligible for the accelerated depreciation recovery periods.

Extend exceptions provided under subpart F for certain active financing income.—Under the Subpart F rules, certain U.S. shareholders of a controlled foreign corporation (CFC) are subject to U.S. tax currently on certain income earned by the CFC, whether or not such income is distributed to the shareholders. The income subject to current inclusion under the subpart F rules includes, among other things, "foreign personal holding company income" and insurance income. Foreign personal holding company income generally includes many types of income derived by a financial service company, such as dividends; interest; royalties; rents; annuities; net gains from the sale of certain property, including securities, commodities and foreign currency; and income from notional principal contracts and securities lending activities. Under prior law, for taxable years beginning before 2002, certain income derived in the active conduct of a banking, financing, insurance, or similar business was excepted from Subpart F. This Act extends the exception for five years, to apply to taxable years beginning before January 1, 2007.

Suspend temporarily the provision that disallows certain deductions of mutual life insurance companies.—Life insurance companies may generally deduct policyholder dividends, while dividends to stockholders are not deductible. Section 809 of the Internal Revenue Code attempts to identify amounts returned by mutual life insurance companies to holders of participating polices in their role as owners of the company, and generally disallows a deduction for mutual company policyholder dividends (or otherwise increases taxable income by reducing the amount of end-of-year reserves) in an amount equal to the amount identified by section 809. The section 809 imputed amount is termed the company's differential earnings amount, and equals the product of the individual company's average equity base and an industry-wide computed differential earnings rate. The differential earnings rate is initially computed using the average mutual earnings rate for the second year preceding the current taxable year, but is later recomputed using the current year's average mutual earnings rate. Any difference between the differential earnings amount and the recomputed differential earnings amount is taken into account in computing taxable income for the following taxable year. Effective for taxable years beginning in 2001, 2002, and 2003, this Act provides a zero differential earnings rate for purposes of computing the differential earnings amount and the recomputed differential earnings amount, thereby temporarily suspending the income imputation for mutual life insurance companies provided under section 809.

TRADE ACT OF 2002

This Act authorizes the President to enter into trade agreements with foreign countries regarding tariff and non-tariff barriers whenever he determines that these barriers unduly burden or restrict U.S. foreign trade or adversely affect the U.S. economy. Expedited procedures for Congressional consideration of the legislation to implement these trade agreements, without amendment, are also authorized. Other provisions of the Act reauthorize the Customs Service, reauthorize and expand certain benefits under the Trade Adjustment Assistance program, extend and expand trade benefits to Andean countries, reauthorize duty-free treatment under the Generalized System of Preferences program for developing countries, and make other trade-related changes. The major provisions of the Act that affect receipts are described below.

Provide refundable tax credit for the purchase of qualified health insurance by certain individuals.—A refundable tax credit is provided to eligible individuals for the cost of qualified health insurance for the individual and qualifying family members. The credit is equal to 65 percent of the amount paid by certain individuals certified as eligible for Trade Adjustment Assistance or alternative Trade Adjustment Assistance, and certain retired workers whose pensions are paid by the Pension Benefit Guaranty Corporation and who are not eligible for Medicare. Payment of the credit is available on an advance basis (i.e, prior to the filing of the taxpayer's return) pursuant to a program to be established by the Secretary of the Treasury no later than August 1, 2003. The credit first became available for months beginning December 2002.

Extend and expand Andean trade preferences.—This Act extends and enhances the Andean Trade Preference Act (ATPA), which expired on December 4, 2001, through December 31, 2006. The ATPA, which was enacted in 1991, was designed to provide economic alternatives for Bolivia, Columbia, Ecuador, and Peru in their fight against narcotics production and trafficking.

Extend Generalized System of Preferences (GSP).—Under GSP, duty-free access is provided to over 4,000 items from eligible developing countries that meet certain worker rights, intellectual property protection, and other criteria. This Act extends this program, which had expired after September 30, 2001, through December 31, 2006.

Modify miscellaneous trade provisions.—Other trade-related changes made by this Act include: (1) modification of benefits provided under the Caribbean Basin Trade Partnership Act and the Africa Growth and Opportunity Act, (2) an increase in the aggregate value of goods that U.S. residents traveling abroad may bring into the United States duty free, and (3) the provision of duty-free treatment to certain steam or vapor generating boilers used in nuclear facilities.

ADMINISTRATION PROPOSALS

The President's plan provides tax incentives for charitable giving, strengthening education, investing in health care, and protecting the environment. It also provides tax incentives designed to increase energy production and promote energy conservation, temporarily extends provisions that are scheduled to expire, permanently extends the research and experimentation (R&E) tax credit, and permanently extends the provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) that sunset on December 31, 2010. In addition, the President intends to work with the Congress to enact an economic growth package that will increase the momentum of the economic recovery and enhance long-term growth.

Last year's Budget announced the Administration's tax simplification project, which is focusing on immediately achievable reforms of the current tax system. Several proposals in this year's Budget result from this project. They include the proposals relating to: creating a uniform definition of a qualifying child, eliminating the phaseout of adoption tax benefits, repealing the restrictions on the use of qualified 501(c)(3) bonds in refinancing taxable debt and working capital debt and in providing residential rental housing, simplifying use of the orphan drug tax credit for pre-designation costs, excluding from income the value of employer-provided computers, consolidating IRAs into Lifetime Savings Accounts and Retirement Savings Accounts (LSAs/RSAs), consolidating defined contribution retirement plans into Employer Retirement Savings Accounts (ERSAs), allowing section 179 expensing elections to be made or revoked on amended returns, and conforming and simplifying the work opportunity tax credit and the welfare to work tax credit. Additional tax simplification proposals are under development and review and will be released during the coming year.

ECONOMIC GROWTH PACKAGE

The President believes that it is crucial for the Congress to pass an economic growth package quickly that will reinvigorate the economic recovery and provide new jobs, reduce tax burdens, and strengthen investor confidence. The provisions of the Administration's proposal that affect receipts are described below.

Accelerate 10-percent individual income tax rate bracket expansion.—Under EGTRRA, effective for taxable years beginning before January 1, 2011, the 15-percent individual income tax rate bracket of prior law is split into two tax rate brackets of 10 and 15 percent. The 10-percent tax rate bracket applies to the first $6,000 of taxable income for single taxpayers and married taxpayers filing separate returns (increasing to $7,000 for taxable years beginning after December 31, 2007), the first $10,000 of taxable income for heads of household, and the first $12,000 of taxable income for married taxpayers filing joint returns (increasing to $14,000 of taxable income for taxable years beginning after December 31, 2007). Taxable income above these thresholds that was taxed at the 15-percent rate under prior law continues to be taxed at that rate. The income thresholds for the new tax rate brackets are adjusted annually for inflation, effective for taxable years beginning after December 31, 2008 and before January 1, 2011.

To spur consumer confidence and economic growth, the Administration proposes to accelerate the expansion of the 10-percent bracket scheduled for 2008 to 2003. Effective for taxable years beginning after December 31, 2002, the 10-percent tax rate bracket would apply to the first $7,000 of taxable income for single taxpayers and married taxpayers filing separate returns, the first $10,000 of taxable income for heads of household, and the first $14,000 of taxable income for married taxpayers filing joint returns. The income thresholds for the 10-percent tax rate brackets would be adjusted annually for inflation, effective for taxable years beginning after December 31, 2003. As a result of the Administration's proposal to extend the EGTRRA provisions permanently, the expanded 10-percent individual income tax rate bracket would also apply to taxable years beginning after December 31, 2010.

Accelerate reduction in individual income tax rates.—In addition to splitting the 15-percent tax rate bracket of prior law into two tax rate brackets (see preceding discussion), EGTRRA replaces the four remaining statutory individual income tax rate brackets of prior law (28, 31, 36, and 39.6 percent) with a rate structure of 25, 28, 33, and 35 percent. The reduced tax rate structure is phased in over a period of six years, effective for taxable years beginning after December 31, 2000, as follows: the 28-percent rate is reduced to 27.5 percent for 2001, 27 percent for 2002 and 2003, 26 percent for 2004 and 2005, and 25 percent for 2006 through 2010; the 31 percent rate is reduced to 30.5 percent for 2001, 30 percent for 2002 and 2003, 29 percent for 2004 and 2005, and 28 percent for 2006 through 2010; the 36 percent rate is reduced to 35.5 percent for 2001, 35 percent for 2002 and 2003, 34 percent for 2004 and 2005, and 33 percent for 2006 through 2010; and the 39.6 percent rate is reduced to 39.1 percent for 2001, 38.6 percent for 2002 and 2003, 37.6 percent for 2004 and 2005, and 35 percent for 2006 through 2010. The income thresholds for these tax rate brackets are adjusted annually for inflation.

To improve the incentives to work, save and invest, the Administration proposes to accelerate the reductions in income tax rates scheduled for 2004 and 2006 to 2003. Effective for taxable years beginning after December 31, 2002, the 27-percent rate would be reduced to 25 percent, the 30-percent rate would be reduced to 28 percent, the 35-percent rate would be reduced to 33 percent, and the 38.6-percent rate would be reduced to 35 percent. These rates would remain in effect for taxable years beginning after December 31, 2010 as a result of the Administration's proposal to extend the EGTRRA provisions permanently.

Accelerate 15-percent individual income tax rate bracket expansion for married taxpayers filing joint returns.—The maximum taxable income in the 15-percent tax rate bracket for a married couple filing a joint return is 167 percent of the corresponding amount for an unmarried individual filing a single return. Therefore, a two-earner couple may have a greater individual income tax liability if they file a joint return than what it would be if they were not married and each filed a separate return. Under EGTRRA, the size of the 15-percent tax rate bracket for married taxpayers filing joint returns is increased over a four-year period, beginning after December 31, 2004. The increase is as follows: the maximum taxable income in the 15-percent tax rate bracket for married taxpayers filing joint returns increases to 180 percent of the corresponding amount for single taxpayers in taxable year 2005, 187 percent in taxable year 2006, 193 percent in taxable year 2007, and 200 percent in taxable years 2008, 2009, and 2010.

The Administration proposes to reduce the marriage penalty by increasing the maximum taxable amount in the 15-percent tax rate bracket for married taxpayers filing joint returns to 200 percent of the corresponding amount for single taxpayers, effective for taxable years beginning after December 31, 2002. As a result of the Administration's proposal to extend EGTRRA permanently, the expanded 15-percent tax rate bracket for married taxpayers would also apply to taxable years beginning after December 31, 2010.

Accelerate increase in standard deduction for married taxpayers filing joint returns.—The basic standard deduction amount for a married couple filing a joint return is 167 percent of the basic standard deduction for an unmarried individual filing a single return. Therefore, two single taxpayers have a combined standard deduction that exceeds the standard deduction of a married couple filing a joint return. Under EGTRRA, the standard deduction for married couples filing joint returns is increased to double the standard deduction for single taxpayers over a five-year period, beginning after December 31, 2004. The standard deduction for married taxpayers filing joint returns increases to 174 percent of the standard deduction for single taxpayers in taxable year 2005, 184 percent in taxable year 2006, 187 percent in taxable year 2007, 190 percent in taxable year 2008, and 200 percent in taxable years 2009 and 2010.

The Administration proposes to reduce the marriage penalty by increasing the standard deduction for married taxpayers filing joint returns to 200 percent of the standard deduction for single taxpayers, effective for taxable years beginning after December 31, 2002. As a result of the Administration's proposal to extend EGTRRA permanently, the increase in the standard deduction for married taxpayers would also apply to taxable years beginning after December 31, 2010.

Accelerate increase in child tax credit.—Current law provides taxpayers a tax credit of up to $600 for each qualifying child under the age of 17. The credit increases to $700 for taxable years 2005 through 2008, $800 for taxable year 2009, and $1,000 for taxable year 2010. The credit declines to $500 in taxable year 2011. The credit is reduced by $50 for each $1,000 (or fraction thereof) by which the taxpayer's modified adjusted gross income exceeds $110,000 ($75,000 if the taxpayer is not married and $55,000 if the taxpayer is married but filing a separate return). These income thresholds are not adjusted for inflation. For taxable years before January 1, 2011, the credit offsets both the regular and the alternative minimum tax.

The child tax credit is refundable to the extent of 10 percent of the taxpayer's earned income in excess of $10,500. The percentage increases to 15 percent for taxable years 2005 through 2010. The $10,500 earned income threshold is indexed annually for inflation. Families with three or more children are allowed a refundable credit for the amount by which their social security payroll taxes exceed the refundable portion of their earned income tax credit, if that amount is greater than the refundable credit based on their earned income in excess of $10,500. For taxable years beginning after December 31, 2010, the credit is nonrefundable unless the taxpayer has three or more children and social security taxes in excess of the refundable portion of the earned income tax credit.

To assist families with the costs of raising children, the Administration proposes to increase the amount of the child tax credit by $400 to $1,000 per child. The proposal would be effective for taxable years beginning after December 31, 2002. For 2003, the increased amount of the child tax credit would be paid in advance beginning in July on the basis of information on the taxpayer's 2002 tax return filed in 2003. Advance payments would be made in a manner similar to the distribution of advance payment checks in 2001. The Administration is also proposing to extend the EGTRRA provisions permanently. Thus, in taxable years beginning after December 31, 2010, the credit would be $1,000, would offset the alternative minimum tax, and would be partially refundable for families with one or two children.

Eliminate the double taxation of corporate earnings.—For corporate stock held in taxable accounts, corporate profits may be taxed twice, once at the shareholder level and once at the corporate level. If the distribution is made through multiple corporations, profits may be taxed more than twice. In contrast, most other forms of capital income (i.e., interest payments, partnership income, and sole-proprietorship income) are taxed only once. The double taxation of corporate earnings contributes to a number of economic distortions. These include a tax bias that (a) discourages investing in corporations in favor of investing in unincorporated forms of business and in consumer durables, (b) discourages financing corporate investment with equity in favor of financing with debt, and (c) discourages distributing earnings as dividends in favor of distributing earnings via share repurchases or retaining and reinvesting them. By reducing or eliminating these tax biases, the Administration's proposal allows markets, rather than taxes, to determine business investment and financing decisions. The Administration's proposal, which would be effective for taxable years beginning in 2003, would relieve the double tax on corporate profits by granting tax relief to shareholders. Shareholders would exclude from taxable income dividends that have been taxed at the corporate level. Excludable dividends would come from an excludable dividend account (EDA), which would reflect income on which the corporation had paid tax at the highest corporate tax rate. Relief from double taxation also would be extended to retained earnings through a shareholder basis adjustment. Shareholders would receive an increase in basis for amounts of taxed corporate earnings that are not paid out as a dividend. This would relieve the capital gains tax on the retained corporate earnings. The basis adjustment would treat the shareholder as if he or she had received a dividend and reinvested it in the corporation.

Increase expensing for small business.—In lieu of depreciation, a taxpayer with less than $200,000 in annual investment may elect to deduct up to $25,000 ($24,000 in 2001 and 2002) of the cost of qualifying property placed in service during the taxable year. The amount that a small business may expense is reduced by the amount by which the cost of qualifying property exceeds $200,000. An election for the increased deduction must generally be made on the taxpayer's initial tax return to which the election applies and the election can only be revoked with the consent of the Commissioner. The Administration proposes to increase the deduction to $75,000 for taxpayers with less than $325,000 in annual investment (with both limits indexed annually for inflation) and include off-the-shelf computer software as qualifying property. Additionally, the Administration proposes to allow expensing elections to be made or revoked on amended returns. The proposal would be effective for taxable years beginning on or after January 1, 2003.

Provide minimum tax relief to individuals.—To ensure that the benefits from the acceleration of the individual income tax reductions are not reduced by the AMT, the Administration proposes to increase the AMT exemption amount in 2003 and 2004 by $8,000 for married taxpayers and by $4,000 for single taxpayers, and maintain those exemption levels through 2005.

TAX INCENTIVES

Provide Incentives for Charitable Giving

Provide charitable contribution deduction for nonitemizers.—Under current law, individual taxpayers who do not itemize their deductions (nonitemizers) are not able to deduct contributions to qualified charitable organizations. The Administration proposes to allow nonitemizers to deduct charitable contributions of cash in addition to claiming the standard deduction, effective for taxable years beginning after December 31, 2002. Nonitemizers would be allowed to deduct cash contributions that exceed $250 ($500 for married taxpayers filing jointly), up to a maximum deduction of $250 ($500 for married taxpayers filing jointly). The deduction floor and limits would be indexed for inflation after 2003. Deductible contributions would be subject to existing rules governing itemized charitable contributions, such as the substantiation requirements.

Permit tax-free withdrawals from IRAs for charitable contributions.—Under current law, eligible individuals may make deductible or non-deductible contributions to a traditional IRA. Pre-tax contributions and earnings in a traditional IRA are included in income when withdrawn. Effective for distributions after December 31, 2002, the Administration proposes to allow individuals who have attained age 65 to exclude from gross income IRA distributions made directly to a charitable organization. The exclusion would apply without regard to the percentage-of-AGI limitations that apply to deductible charitable contributions. The exclusion would apply only to the extent the individual receives no return benefit in exchange for the transfer, and no charitable deduction would be allowed with respect to any amount that is excludable from income under this provision.

Expand and increase the enhanced charitable deduction for contributions of food inventory.—A taxpayer's deduction for charitable contributions of inventory generally is limited to the taxpayer's basis (typically cost) in the inventory. However, for certain contributions of inventory, C corporations may claim an enhanced deduction equal to the lesser of: (1) basis plus one half of the fair market value in excess of basis, or (2) two times basis. To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer contributed to a charitable organization and the donee must (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants, (2) not transfer the property in exchange for money, other property, or services, and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements. To use the enhanced deduction, the taxpayer must establish that the fair market value of the donated item exceeds basis.

Under the Administration's proposal, which is designed to encourage contributions of food inventory to charitable organizations, any taxpayer engaged in a trade or business would be eligible to claim an enhanced deduction for donations of food inventory. The enhanced deduction for donations of food inventory would be increased to the lesser of: (1) fair market value, or (2) two times basis. However, to ensure consistent treatment of all businesses claiming an enhanced deduction for donations of food inventory, the enhanced deduction for qualified food donations by S corporations and non-corporate taxpayers would be limited to 10 percent of net income from the trade or business. A special provision would allow taxpayers with a zero or low basis in the qualified food donation (e.g., taxpayers that use the cash method of accounting for purchases and sales, and taxpayers that are not required to capitalize indirect costs) to assume a basis equal to 25 percent of fair market value. The enhanced deduction would be available only for donations of "apparently wholesome food" (food intended for human consumption that meets all quality and labeling standards imposed by Federal, state, and local laws and regulations, even though the food may not be readily marketable due to appearance, age, freshness, grade, size, surplus, or other conditions). The fair market value of "apparently wholesome food" that cannot or will not be sold solely due to internal standards of the taxpayer or lack of market, would be determined by taking into account the price at which the same or substantially the same food items are sold by the taxpayer at the time of the contribution or, if not sold at such time, in the recent past. These proposed changes in the enhanced deduction for donations of food inventory would be effective for taxable years beginning after December 31, 2002.

Reform excise tax based on investment income of private foundations.—Under current law, private foundations that are exempt from Federal income tax are subject to a two-percent excise tax on their net investment income (one-percent if certain requirements are met). The excise tax on private foundations that are not exempt from Federal income tax, such as certain charitable trusts, is equal to the excess of the sum of the excise tax that would have been imposed if the foundation were tax exempt and the amount of the unrelated business income tax that would have been imposed if the foundation were tax exempt, over the income tax imposed on the foundation. To encourage increased charitable activity and simplify the tax laws, the Administration proposes to replace the two rates of tax on the net investment income of private foundations that are exempt from Federal income tax with a single tax rate of one percent. The excise tax on private foundations not exempt from Federal income tax would be equal to the excess of the sum of the one-percent excise tax that would have been imposed if the foundation were tax exempt and the amount of the unrelated business income tax what would have been imposed if the foundation were tax exempt, over the income tax imposed on the foundation. The proposed change would be effective for taxable years beginning after December 31, 2002.

Modify tax on unrelated business taxable income of charitable remainder trusts.—A charitable remainder annuity trust is a trust that is required to pay, at least annually, a fixed dollar amount of at least five percent of the initial value of the trust to a non-charity for the life of an individual or for a period of 20 years or less, with the remainder passing to charity. A charitable remainder unitrust is a trust that generally is required to pay, at least annually, a fixed percentage of at least five percent of the fair market value of the trust's assets determined at least annually to a non-charity for the life of an individual or for a period of 20 years or less, with the remainder passing to charity. A trust does not qualify as a charitable remainder annuity trust if the annuity for a year is greater than 50 percent of the initial fair market value of the trust's assets. A trust does not qualify as a charitable remainder unitrust if the percentage of assets that are required to be distributed at least annually is greater than 50 percent. A trust does not qualify as a charitable remainder annuity trust or a charitable remainder unitrust unless the value of the remainder interest in the trust is at least 10 percent of the value of the assets contributed to the trust. Distributions from a charitable remainder annuity trust or charitable remainder unitrust, which are included in the income of the beneficiary for the year that the amount is required to be distributed, are treated in the following order as: (1) ordinary income to the extent of the trust's current and previously undistributed ordinary income for the trust's year in which the distribution occurred, (2) capital gains to the extent of the trust's current capital gain and previously undistributed capital gain for the trust's year in which the distribution occurred, (3) other income to the extent of the trust's current and previously undistributed other income for the trust's year in which the distribution occurred, and (4) corpus (trust principal).

Charitable remainder annuity trusts and charitable remainder unitrusts are exempt from Federal income tax; however, such trusts lose their income tax exemption for any year in which they have unrelated business taxable income. Any taxes imposed on the trust are required to be allocated to trust corpus. The Administration proposes to levy a 100-percent excise tax on the unrelated business taxable income of charitable remainder trusts, in lieu of removing the Federal income tax exemption for any year in which unrelated business taxable income is incurred. This change, which is a more appropriate remedy than loss of tax exemption, is proposed to become effective for taxable years beginning after December 31, 2002, regardless of when the trust was created.

Modify basis adjustment to stock of S corporations contributing appreciated property.—Under current law, each shareholder in an S corporation separately accounts for his or her pro rata share of the S corporation's charitable contributions in determining his or her income tax liability. A shareholder's basis in the stock of the S corporation must be reduced by the amount of his or her pro rata share of the S corporation's charitable contribution. In order to preserve the benefit of providing a charitable contribution deduction for contributions of appreciated property and to prevent the recognition of gain on the contributed property on the disposition of the S corporation stock, the Administration proposes to allow a shareholder in an S corporation to increase his or her basis in the stock of an S corporation by an amount equal to the excess of the shareholder's pro rata share of the S corporation's charitable contribution over the stockholder's pro rata share of the adjusted basis of the contributed property. The proposal would be effective for taxable years beginning after December 31, 2002.

Repeal the $150 million limitation on qualified 501(c)(3) bonds.—Current law contains a $150 million limitation on the volume of outstanding, non-hospital, tax-exempt bonds for the benefit of any one 501(c)(3) organization. The limitation was repealed in 1997 for bonds issued after August 5, 1997, at least 95 percent of the net proceeds of which are used to finance capital expenditures incurred after that date. However, the limitation continues to apply to bonds more than five percent of the net proceeds of which finance or refinance working capital expenditures, or capital expenditures incurred on or before August 5, 1997. In order to simplify the tax laws and provide consistent treatment of bonds for 501(c)(3) organizations, the Administration proposes to repeal the $150 million limitation in its entirety.

Repeal restrictions on the use of qualified 501(c)(3) bonds for residential rental property.— Tax-exempt, 501(c)(3) organizations generally may utilize tax-exempt financing for charitable purposes. However, existing law contains a special limitation under which 501(c)(3) organizations may not use tax-exempt financing to acquire existing residential rental property for charitable purposes unless the property is rented to low-income tenants or is substantially rehabilitated. In order to simplify the tax laws and provide consistent treatment of bonds for 501(c)(3) organizations, the Administration proposes to repeal the residential rental property limitation.

Strengthen and Reform Education

Provide refundable tax credit for certain costs of attending a different school for pupils assigned to failing public schools.—Under the Administration's proposal, a refundable tax credit would be allowed for 50 percent of the first $5,000 of qualifying elementary and secondary education expenses incurred during the taxable year with respect to enrollment of a qualifying student in a qualifying school. Qualifying students would be those who, for a given school year, would normally attend a public school determined by the State as not having made "adequate yearly progress" under the terms of the Elementary and Secondary Education Act as amended by the No Child Left Behind Act of 2001. A qualifying student in one school year generally would qualify for an additional school year even if the school normally attended made adequate yearly progress by the beginning of the second school year. A qualifying school would be any public school making adequate yearly progress or private elementary or secondary school. Qualifying expenses generally would be tuition, required fees, and transportation costs incurred by the taxpayer in connection with the attendance at a qualifying school. The proposal would be effective with respect to expenses incurred beginning with the 2003–2004 school year through the 2007–2008 school year.

Extend, increase and expand the above-the-line deduction for qualified out-of-pocket classroom expenses.—Under current law, teachers who itemize deductions (do not use the standard deduction) and incur unreimbursed, job-related expenses are allowed to deduct those expenses to the extent that when combined with other miscellaneous itemized deductions they exceed two percent of AGI. Current law also allows certain teachers and other elementary and secondary school professionals to treat up to $250 in annual qualified out-of-pocket classroom expenses as a non-itemized deduction (above-the-line deduction), effective for expenses incurred in taxable years beginning after December 31, 2001 and before January 1, 2004. Unreimbursed expenditures for certain books, supplies and equipment related to classroom instruction qualify for the above-the-line deduction. Expenses claimed as an above-the-line deduction cannot be claimed as an itemized deduction. The Administration proposes to extend the above-the-line deduction to apply to qualified out-of-pocket expenditures incurred after December 31, 2003, to increase the deduction to $400, and to expand the deduction to apply to unreimbursed expenditures for certain professional training programs.

Invest in Health Care

Provide refundable tax credit for the purchase of health insurance.—Current law provides a tax preference for employer-provided group health insurance plans, but not for individually purchased health insurance coverage except to the extent that deductible medical expenses exceed 7.5 percent of AGI, the individual has self-employment income, or the individual is eligible under the Trade Act of 2002 to purchase certain types of qualified health insurance. The Administration proposes to make health insurance more affordable for individuals not covered by an employer plan or a public program. Effective for taxable years beginning after December 31, 2003, a new refundable tax credit would be provided for the cost of health insurance purchased by individuals under age 65. The credit would provide a subsidy for a percentage of the health insurance premium, up to a maximum includable premium. The maximum subsidy percentage would be 90 percent for low-income taxpayers and would phase down with income. The maximum credit would be $1,000 for an adult and $500 for a child. The credit would be phased out at $30,000 for single taxpayers and $60,000 for families purchasing a family policy.

Individuals could claim the tax credit for health insurance premiums paid as part of the normal tax-filing process. Alternatively, beginning July 1, 2005, the tax credit would be available in advance at the time the individual purchases health insurance. The advance credit would reduce the premium paid by the individual to the health insurer, and the health insurer would be reimbursed directly by the Department of Treasury for the amount of the advance credit. Eligibility for an advance credit would be based on an individual's prior year tax return. To qualify for the credit, a health insurance policy would have to include coverage for catastrophic medical expenses. Qualifying insurance could be purchased in the individual market. Qualifying health insurance could also be purchased through private purchasing groups, state-sponsored insurance purchasing pools, and high-risk pools. Such groups may help reduce health insurance costs and increase coverage options for individuals, including older and higher-risk individuals. Individuals would not be allowed to claim the credit and make a contribution to an Archer MSA for the same taxable year.

Provide an above-the-line deduction for long-term care insurance premiums.—Current law provides a tax preference for employer-paid long-term care insurance. However, the vast majority of the long-term care insurance market consists of individually purchased policies, for which no tax preference is provided except to the extent that deductible medical expenses exceed 7.5 percent of AGI or the individual has self-employment income. Premiums on qualified long-term care insurance are deductible as a medical expense, subject to annual dollar limitations that increase with age. The Administration proposes to make individually-purchased long-term care insurance (the vast majority of the long-term care insurance market) more affordable by creating an above-the-line deduction for qualified long-term care insurance premiums. To qualify for the deduction, the long-term care insurance would be required to meet certain standards providing consumer protections. The deduction would be available to taxpayers who individually purchase qualified long-term care insurance and to those who pay at least 50 percent of the cost of employer-provided coverage. The deduction would be effective for taxable years beginning after December 31, 2003 but would be phased in over four years. The deduction would be subject to current law annual dollar limitations on qualified long-term care insurance premiums.

Allow up to $500 in unused benefits in a health flexible spending arrangement to be carried forward to the next year.—Under current law, unused benefits in a health flexible spending arrangement under a cafeteria plan for a particular year revert to the employer at the end of the year. Effective for plan years beginning after December 31, 2003, the Administration proposes to allow up to $500 in unused benefits in a health flexible spending arrangement at the end of a particular year to be carried forward to the next plan year.

Provide additional choice with regard to unused benefits in a health flexible spending arrangement.—In addition to the proposed carryforward of unused benefits (see preceding discussion), the Administration proposes to allow up to $500 in unused benefits in a health flexible spending arrangement at the end of a particular year to be distributed to the participant as taxable income, contributed to an Archer MSA, or contributed as a deferral to an employer's funded retirement plan. Amounts distributed to the participant would be subject to income tax withholding and employment taxes. Amounts contributed to an Archer MSA or retirement plan would be subject to the normal rules applicable to elective contributions to the receiving plan or account. The proposal would be effective for plan years beginning after December 31, 2003.

Permanently extend and reform Archer Medical Savings Accounts.—Current law allows only self-employed individuals and employees of small firms to establish Archer MSAs, and caps the number of accounts at 750,000. In addition to other requirements, (1) individuals who establish MSAs must be covered by a high-deductible health plan (and no other plan) with a deductible of at least $1,700 but not greater than $2,500 for policies covering a single person and a deductible of at least $3,350 but not greater than $5,050 in all other cases, (2) tax-preferred contributions are limited to 65 percent of the deductible for single policies and 75 percent of the deductible for other policies, and (3) either an individual or an employer, but not both, may make a tax-preferred contribution to an MSA for a particular year. The Administration proposes to permanently extend the MSA program, which is scheduled to expire on December 31, 2003, and to modify the program to make it more consistent with currently available health plans. Effective after December 31, 2003, the Administration proposes to remove the 750,000 cap on the number of accounts. In addition, the program would be reformed by (1) expanding eligibility to include all individuals and employees of firms of all sizes covered by a high-deductible health plan, (2) modifying the definition of high deductible to permit a deductible as low as $1,000 for policies covering a single person and $2,000 in all other cases, (3) increasing allowable tax-preferred contributions to 100 percent of the deductible, (4) allowing tax-preferred contributions by both employers and employees for a particular year, up to the applicable maximum, (5) allowing contributions to MSAs under cafeteria plans, and (6) permitting qualified plans to provide, without counting against the deductible, up to $100 of coverage for allowable preventive services per covered individual each year. Individuals would not be allowed to make a contribution to an MSA and claim the proposed refundable tax credit for health insurance premiums for the same taxable year.

Provide an additional personal exemption to home caregivers of family members.—Current law provides a tax deduction for certain long-term care expenses. In addition, taxpayers are allowed to claim exemptions for themselves (and their spouses, if married) and dependents who they support. However, neither provision may meet the needs of taxpayers who provide long-term care in their own home for close family members. Effective for taxable years beginning after December 31, 2003, the Administration proposes to provide an additional personal exemption to taxpayers who care for certain qualified family members who reside with the taxpayer in the household maintained by the taxpayer. A taxpayer is considered to maintain a household only if he or she furnishes over half of the annual cost of maintaining the household. Qualified family members would include any individual with long-term care needs who is (1) the spouse of the taxpayer or an ancestor of the taxpayer or the spouse of such an ancestor and (2) a member of the taxpayer's household for the entire year. An individual would be considered to have long-term care needs if he or she were certified by a licensed physician (prior to the filing of a return claiming the exemption) as, for at least 180 consecutive days, unable to perform at least two activities of daily living without substantial assistance from another individual due to a loss of functional capacity; or, alternatively, (1) requiring substantial supervision to be protected from threats to his or her own health and safety due to severe cognitive impairment and (2) being unable to perform at least one activity of daily living or being unable to engage in age appropriate activities.

Allow the orphan drug tax credit for certain pre-designation expenses.—Current law provides a 50-percent credit for expenses related to human clinical testing of drugs for the treatment of certain rare diseases and conditions ("orphan drugs"). A taxpayer may claim the credit only for expenses incurred after the Food and Drug Administration (FDA) designates a drug as a potential treatment for a rare disease or condition. This creates an incentive to defer clinical testing for orphan drugs until the taxpayer receives the FDA's approval and increases complexity for taxpayers by treating pre-designation and post-designation clinical expenses differently. The Administration proposes to allow taxpayers to defer claiming the orphan drug tax credit until the drug receives FDA designation as a potential treatment for a rare disease or condition. The taxpayer would be permitted to claim the credit for pre-designation costs either in the year of approval, or to file an amended return to claim the credit for prior years. The proposal would be effective for qualified expenses incurred after December 31, 2002.

Encourage Telecommuting

Exclude from income the value of employer-provided computers, software and peripherals.—Under current law, the value of computers and related equipment and services provided by an employer to an employee for home use is generally allocated between business and personal use. The business-use portion is excluded from the employee's income whereas the personal-use portion is subject to income and payroll taxes. In order to simplify recordkeeping, improve compliance, and encourage telecommuting, the Administration proposes to allow individuals to exclude from income the value of employer-provided computers and related equipment and services necessary to perform work for the employer at home. The employee would be required to make substantial use of the equipment to perform work for the employer. Substantial business use would include standby use for periods when work from home may be required by the employer, such as during work closures caused by the threat of terrorism, inclement weather, or natural disasters. The proposal would be effective for taxable years beginning after December 31, 2003.

Increase Housing Opportunities

Provide tax credit for developers of affordable single-family housing.—The Administration proposes to provide annual tax credit authority to states (including U.S. possessions) designed to promote the development of affordable single-family housing in low-income urban and rural neighborhoods. Beginning in calendar year 2004, first-year credit authority equal to the amount provided for low-income rental housing tax credits would be made available to each state. That amount is equal to the greater of $2 million or $1.75 per capita (indexed annually for inflation after 2002). State housing agencies would award first-year credits to single-family housing units comprising a project located in a census tract with median income equal to 80 percent or less of area median income. Units in condominiums and cooperatives could qualify as single-family housing. Credits would be awarded as a fixed amount for individual units comprising a project. The present value of the credits, determined on the date of a qualifying sale, could not exceed 50 percent of the cost of constructing a new home or rehabilitating an existing property. The taxpayer (developer or investor partnership) owning the housing unit immediately prior to the sale to a qualified buyer would be eligible to claim credits over a five-year period beginning on the date of sale. Eligible homebuyers would be required to have incomes equal to 80 percent or less of area median income. Certain technical features of the provision would follow similar features of current law with respect to the low-income housing tax credit and mortgage revenue bonds.

Encourage Saving

Establish Individual Development Accounts (IDAs).—The Administration proposes to allow eligible individuals to make contributions to a new savings vehicle, the Individual Development Account, which would be set up and administered by qualified financial institutions, nonprofit organizations, or Indian tribes (qualified entities). Citizens or legal residents of the United States between the ages of 18 and 60 who cannot be claimed as a dependent on another taxpayer's return, are not students, and who meet certain income limitations would be eligible to establish and contribute to an IDA. A single taxpayer would be eligible to establish and contribute to an IDA if his or her modified AGI in the preceding taxable year did not exceed $20,000 ($30,000 for heads of household, and $40,000 for married taxpayers filing a joint return). These thresholds would be indexed annually for inflation beginning in 2005. Qualified entities that set up and administer IDAs would be required to match, dollar-for-dollar, the first $500 contributed by an eligible individual to an IDA in a taxable year. Qualified entities would be allowed a 100 percent tax credit for up to $500 in annual matching contributions to each IDA, and a $50 tax credit for each IDA maintained at the end of a taxable year with a balance of not less that $100 (excluding the taxable year in which the account was established). Matching contributions and the earnings on those contributions would be deposited in a separate "parallel account." Contributions to an IDA by an eligible individual would not be deductible, and earnings on those contributions would be included in income. Matching contributions by qualified entities and the earnings on those contributions would be tax-free. Withdrawals from the parallel account may be made only for qualified purposes (higher education, the first-time purchase of a home, business start-up, and qualified rollovers). Withdrawals from the IDA for other than qualified purposes may result in the forfeiture of some or all matching contributions and the earnings on those contributions. The proposal would be effective for contributions made after December 31, 2004 and before January 1, 2012, to the first 900,000 IDA accounts opened before January 1, 2010.

Protect the Environment

Permanently extend expensing of brownfields remediation costs.—Taxpayers may elect to treat certain environmental remediation expenditures that would otherwise be chargeable to capital account as deductible in the year paid or incurred. Under current law, the ability to deduct such expenditures expires with respect to expenditures paid or incurred after December 31, 2003. The Administration proposes to permanently extend this provision, facilitating its use by businesses to undertake projects that may extend beyond the current expiration date and be uncertain in overall duration.

Exclude 50 percent of gains from the sale of property for conservation purposes.—The Administration proposes to create a new incentive for private, voluntary land protection. This incentive is a cost-effective, non-regulatory approach to conservation. Under the proposal, when land (or an interest in land or water) is sold for conservation purposes, only 50 percent of any gain would be included in the seller's income. This proposal applies to conservation easements and similar sales of partial interest in land for conservation purposes, such as development rights and agricultural conservation easements. To be eligible for the exclusion, the sale may be either to a government agency or to a qualified conservation organization, and the buyer must supply a letter of intent that the acquisition will serve conservation purposes. In addition, the taxpayer or a member of the taxpayer's family must have owned the property for the three years immediately preceding the sale. Antiabuse provisions will ensure that the conservation purposes continue to be served. The provision would be effective for sales taking place on or after January 1, 2004.

Increase Energy Production and Promote Energy Conservation

Extend and modify the tax credit for producing electricity from certain sources.—Taxpayers are provided a 1.5-cent-per-kilowatt-hour tax credit, adjusted for inflation after 1992, for electricity produced from wind, closed-loop biomass (organic material from a plant grown exclusively for use at a qualified facility to produce electricity), and poultry waste. To qualify for the credit, the electricity must be sold to an unrelated third party and must be produced during the first 10 years of production at a facility placed in service before January 1, 2004. The Administration proposes to extend the credit for electricity produced from wind and biomass to facilities placed in service before January 1, 2006. In addition, eligible biomass sources would be expanded to include certain biomass from forest-related resources, agricultural sources, and other specified sources. Special rules would apply to biomass facilities placed in service before January 1, 2003. Electricity produced at such facilities from newly eligible sources would be eligible for the credit only from January 1, 2003 through December 31, 2005, and at a rate equal to 60 percent of the generally applicable rate. Electricity produced from newly eligible biomass co-fired in coal plants would also be eligible for the credit only from January 1, 2003 through December 31, 2005, and at a rate equal to 30 percent of the generally applicable rate. The Administration also proposes to modify the rules relating to governmental financing of qualified facilities. There would be no percentage reduction in the credit for governmental financing attributable to tax-exempt bonds. Instead, such financing would reduce the credit only to the extent necessary to offset the value of the tax exemption. The rules relating to leased facilities would also be modified to permit the lessee, rather than the owner, to claim the credit.

Provide tax credit for residential solar energy systems.—Current law provides a 10-percent investment tax credit to businesses for qualifying equipment that uses solar energy to generate electricity; to heat, cool or provide hot water for use in a structure; or to provide solar process heat. A credit currently is not provided for nonbusiness purchases of solar energy equipment. The Administration proposes a new tax credit for individuals who purchase solar energy equipment to generate electricity (photovoltaic equipment) or heat water (solar water heating equipment) for use in a dwelling unit that the individual uses as a residence, provided the equipment is used exclusively for purposes other than heating swimming pools. The proposed nonrefundable credit would be equal to 15 percent of the cost of the equipment and its installation; each individual taxpayer would be allowed a maximum credit of $2,000 for photovoltaic equipment and $2,000 for solar water heating equipment. The credit would apply to photovoltaic equipment placed in service after December 31, 2002 and before January 1, 2008 and to solar water heating equipment placed in service after December 31, 2002 and before January 1, 2006.

Modify treatment of nuclear decommissioning funds.—Under current law, deductible contributions to nuclear decommissioning funds are limited to the amount included in the taxpayer's cost of service for ratemaking purposes. For deregulated utilities, this limitation may result in the denial of any deduction for contributions to a nuclear decommissioning fund. The Administration proposes to repeal this limitation.

Also under current law, deductible contributions are not permitted to exceed the amount the IRS determines to be necessary to provide for level funding of an amount equal to the taxpayer's post-1983 decommissioning costs. The Administration proposes to permit funding of all decommissioning costs through deductible contributions. Any portion of these additional contributions relating to pre-1984 costs that exceeds the amount previously deducted (other than under the nuclear decommissioning fund rules) or excluded from the taxpayer's gross income on account of the taxpayer's liability for decommissioning costs, would be allowed as a deduction ratably over the remaining useful life of the nuclear power plant.

The Administration's proposal would also permit taxpayers to make deductible contributions to a qualified fund after the end of the nuclear power plant's estimated useful life and would provide that nuclear decommissioning costs are deductible when paid. These changes in the treatment of nuclear decommissioning funds are proposed to be effective for taxable years beginning after December 31, 2002.

Provide tax credit for purchase of certain hybrid and fuel cell vehicles.—Under current law, a 10-percent tax credit up to $4,000 is provided for the cost of a qualified electric vehicle. The full amount of the credit is available for purchases prior to 2004. The credit begins to phase down in 2004 and is not available after 2006. A qualified electric vehicle is a motor vehicle that is powered primarily by an electric motor drawing current from rechargeable batteries, fuel cells, or other portable sources of electric current, the original use of which commences with the taxpayer, and that is acquired for use by the taxpayer and not for resale. Electric vehicles and hybrid vehicles (those that have more than one source of power on board the vehicle) have the potential to reduce petroleum consumption, air pollution and greenhouse gas emissions. To encourage the purchase of such vehicles, the Administration is proposing the following tax credits: (1) A credit of up to $4,000 would be provided for the purchase of qualified hybrid vehicles after December 31, 2002 and before January 1, 2008. The amount of the credit would depend on the percentage of maximum available power provided by the rechargeable energy storage system and the amount by which the vehicle's fuel economy exceeds the 2000 model year city fuel economy. (2) A credit of up to $8,000 would be provided for the purchase of new qualified fuel cell vehicles after December 31, 2002 and before January 1, 2008. A minimum credit of $4,000 would be provided, which would increase as the vehicle's fuel efficiency exceeded the 2000 model year city fuel economy, reaching a maximum credit of $8,000 if the vehicle achieved at least 300 percent of the 2000 model year city fuel economy.

Provide tax credit for energy produced from landfill gas.—Taxpayers that produce gas from biomass (including landfill methane) are eligible for a tax credit equal to $3 per barrel-of-oil equivalent (the amount of gas that has a British thermal unit content of 5.8 million), adjusted by an inflation adjustment factor for the calendar year in which the sale occurs. To qualify for the credit, the gas must be produced domestically from a facility placed in service by the taxpayer before July 1, 1998, pursuant to a written binding contract in effect before January 1, 1997. In addition, the gas must be sold to an unrelated person before January 1, 2008. The Administration proposes to extend the credit to apply to landfill methane produced from a facility (or portion of a facility) placed in service after December 31, 2002 and before January 1, 2011, and sold (or used to produce electricity that is sold) before January 1, 2011. The credit for fuel produced at landfills subject to EPA's 1996 New Source Performance Standards/Emissions Guidelines would be limited to two-thirds of the otherwise applicable amount beginning on January 1, 2008, if any portion of the facility for producing fuel at the landfill was placed in service before July 1, 1998, and beginning on January 1, 2003, in all other cases.

Provide tax credit for combined heat and power property.—Combined heat and power (CHP) systems are used to produce electricity (and/or mechanical power) and usable thermal energy from a single primary energy source. Depreciation allowances for CHP property vary by asset use and capacity. No income tax credit is provided under current law for investment in CHP property. CHP systems utilize thermal energy that is otherwise wasted in producing electricity by more conventional methods and achieve a greater level of overall energy efficiency, thereby lessening the consumption of primary fossil fuels, lowering total energy costs, and reducing carbon emissions. To encourage increased energy efficiency by accelerating planned investments and inducing additional investments in such systems, the Administration is proposing a 10-percent investment credit for qualified CHP systems with an electrical capacity in excess of 50 kilowatts or with a capacity to produce mechanical power in excess of 67 horsepower (or an equivalent combination of electrical and mechanical energy capacities). A qualified CHP system would be required to produce at least 20 percent of its total useful energy in the form of thermal energy and at least 20 percent of its total useful energy in the form of electrical or mechanical power (or a combination thereof) and would also be required to satisfy an energy-efficiency standard. For CHP systems with an electrical capacity in excess of 50 megawatts (or a mechanical energy capacity in excess of 67,000 horsepower), the total energy efficiency would have to exceed 70 percent. For smaller systems, the total energy efficiency would have to exceed 60 percent. Investments in qualified CHP assets that are otherwise assigned cost recovery periods of less than 15 years would be eligible for the credit, provided that the taxpayer elects to treat such property as having a 22-year class life (and thus depreciates the property using a 15-year recovery period). The credit, which would be treated as an energy credit under the investment credit component of the general business credit, and could not be used in conjunction with any other credit for the same equipment, would apply to investments in CHP property placed in service after December 31, 2002 and before January 1, 2008.

Provide excise tax exemption (credit) for ethanol.—Under current law an income tax credit and an excise tax exemption are provided for ethanol and renewable source methanol used as a fuel. In general, the income tax credit for ethanol is 52 cents per gallon, but small ethanol producers (those producing less than 30 million gallons of ethanol per year) qualify for a credit of 62 cents per gallon on the first 15 million gallons of ethanol produced in a year. A credit of 60 cents per gallon is allowed for renewable source methanol. As an alternative to the income tax credit, gasohol blenders may claim a gasoline tax exemption of 52 cents for each gallon of ethanol and 60 cents for each gallon of renewable source methanol that is blended into qualifying gasohol. The rates for the ethanol credit and exemption are each reduced by 1 cent per gallon in 2005. The income tax credit expires on December 31, 2007 and the excise tax exemption expires on September 30, 2007. Neither the credit nor the exemption apply during any period in which motor fuel taxes dedicated to the Highway Trust Fund are limited to 4.3 cents per gallon. The Administration proposes to extend both the income tax credit and the excise tax exemption through December 31, 2010. The current law rule providing that neither the credit nor the exemption apply during any period in which motor fuel taxes dedicated to the Highway Trust Fund are limited to 4.3 cents per gallon would be retained.

Promote Trade

Implement free trade agreements with Chile and Singapore.—Free trade agreements are expected to be completed with Chile and Singapore in 2003, with ten-year implementation to begin in fiscal year 2004. These agreements will benefit U.S. producers and consumers, as well as strengthen the economies of Chile and Singapore. In addition, these agreements will establish precedents in our market opening efforts in two important and dynamic regions—Latin America and Southeast Asia.

Improve Tax Administration

Modify the IRS Restructuring and Reform Act of 1998 (RRA98).—The proposed modification to RRA98 is comprised of six parts. The first part modifies employee infractions subject to mandatory termination and permits a broader range of available penalties. It strengthens taxpayer privacy while reducing employee anxiety resulting from unduly harsh discipline or unfounded allegations. The second part adopts measures to curb frivolous submissions and filings that are intended to impede or delay tax administration. The third part allows the IRS to terminate installment agreements when taxpayers fail to make timely tax deposits and file tax returns on current liabilities. The fourth part streamlines jurisdiction over collection due process cases in the Tax Court, thereby simplifying procedures and reducing the cycle time for certain collection due process cases. The fifth part permits taxpayers to enter into installment agreements that do not guarantee full payment of liability over the life of the agreement. It allows the IRS to enter into agreements with taxpayers who desire to resolve their tax obligations but cannot make payments large enough to satisfy their entire liability and for whom an offer in compromise is not a viable alternative. The sixth part eliminates the requirement that the IRS Chief Counsel provide an opinion for any accepted offer-in-compromise of unpaid tax (including interest and penalties) equal to or exceeding $50,000. This proposal requires that the Treasury Secretary establish standards to determine when an opinion is appropriate.

Initiate IRS cost saving measures.—The Administration has two proposals to improve IRS efficiency and performance from current resources. The first proposal modifies the way that Financial Management Services (FMS) recovers its transaction fees for processing IRS levies by permitting FMS to retain a portion of the amount collected before transmitting the balance to the IRS, thereby reducing government transaction costs. The offset amount would be included as part of the

15-percent limit on levies against income and would also be credited against the taxpayer's liability. The second proposal extends the April filing date for electronically filed tax returns by at least ten days to help encourage the growth of electronic filing.

Repeal section 132 of the Revenue Act of 1978 and amend the tax code to authorize the Secretary of the Treasury to issue rules to address inappropriate nonqualified deferred compensation arrangements.—Section 132 currently prohibits the Internal Revenue Service from issuing new regulations on many aspects of nonqualified deferred compensation arrangements, restricting the ability of the IRS to respond effectively to these arrangements. Under the Administration's proposal, that prohibition would be removed and the Secretary of the Treasury would be given express authority to issue new rules. It is expected that new guidance would address when an individual's access to compensation is considered subject to substantial limitation, the extent to which company assets may be designated as available to meet deferred compensation obligations, and when an arrangement is treated as funded.

Permit private collection agencies to engage in specific, limited activities to support IRS collection efforts.—The resource and collection priorities of the IRS do not permit it to continually pursue all outstanding tax liabilities. Many taxpayers are aware of their outstanding tax liabilities but have failed to pay them. The use of private collection agencies, or PCAs, to support IRS collection efforts would enable the Government to reach these taxpayers to obtain payment while allowing the IRS to focus its own enforcement resources on more complex cases and issues. PCAs would not have any enforcement power, and they would be strictly prohibited from threatening enforcement action or violating any taxpayer confidentiality protection or other taxpayer right. The IRS would be required to closely monitor PCA activities and performance, including the protection of taxpayer rights. PCAs would be compensated out of the revenue collected through their activities, although compensation would be based on quality of service, taxpayer satisfaction, and case resolution, in addition to collection results.

Combat abusive tax avoidance transactions.—Although the vast majority of taxpayers and practitioners do their best to comply with the law, some actively promote or engage in transactions structured to generate tax benefits never intended by Congress. Such abusive transactions harm the public fisc, erode the public's respect for the tax laws, and consume valuable IRS resources. The Administration has proposed a number of regulatory and legislative changes designed to significantly enhance the current enforcement regime and curtail the use of abusive tax avoidance transactions. These proposed changes include (1) the modification of the definition of a reportable transaction, (2) the issuance of a coordinated set of disclosure, registration and investor list maintenance rules, (3) the imposition of new or increased penalties for the failure to disclose and register reportable transactions and for the failure to report an interest in a foreign financial account, (4) the prevention of "income separation" transactions structured to create immediate tax losses or to convert current ordinary income into deferred capital gain, and (5) the denial of foreign tax credits with respect to any foreign withholding taxes if the underlying property was not held for a specified minimum period of time. A number of administrative proposals already have been carried out by the Treasury Department and the IRS.

Limit related party interest deductions.—Current law (section 163(j) of the Internal Revenue Code) denies U.S. tax deductions for certain interest expenses paid to a related party where (1) the corporation's debt-equity ratio exceeds 1.5 to 1.0, and (2) net interest expenses exceed 50 percent of the corporation's adjusted taxable income (computed by adding back net interest expense, depreciation, amortization, depletion, and any net operating loss deduction). If these thresholds are exceeded, no deduction is allowed for interest in excess of the 50-percent limit that is paid to a related party and that is not subject to U.S. tax. Any interest that is disallowed in a given year is carried forward indefinitely and may be deductible in a subsequent taxable year. A three-year carryforward for any excess limitation (the amount by which interest expense for a given year falls short of the 50-percent limit) is also allowed. Because of the opportunities available under current law to inappropriately reduce U.S. tax on income earned on U.S. operations through the use of foreign related-party debt, the Administration proposes to tighten the interest disallowance rules of section 163(j).

Reform Unemployment Insurance

Reform unemployment insurance administrative financing.—Current law funds the administrative costs of the unemployment insurance system and related programs out of the Federal Unemployment Tax (FUTA) paid by employers. FUTA is set at 0.8 percent of the first $7,000 in covered wages, which includes a 0.2 percent surtax scheduled to expire in 2007. State unemployment taxes are deposited into the Unemployment Trust Fund and used by States to pay unemployment benefits. Under current law, FUTA balances in excess of statutory ceilings are distributed to the States to pay unemployment benefits or the administrative costs of the system (these are known as Reed Act transfers). The Administration has a comprehensive proposal to reform the administrative financing of this system. It proposes to eliminate the FUTA surtax in 2005, and make additional rate cuts to achieve a net FUTA tax rate of 0.2 percent in 2009. The proposal will transfer administrative funding control to the States in 2006 and allow them to use their benefit taxes to pay these costs. In addition, the Administration supports special distributions of $2.7 billion in Reed Act funds on October 1, 2006 and October 1, 2007, to be used for administrative expenses in the transition.

OTHER PROPOSALS

Deposit full amount of excise tax imposed on gasohol in the Highway Trust Fund.—Under current law, an 18.4-cents-per-gallon excise tax is imposed on gasoline. In general, 18.3 cents per gallon of the gasoline excise tax is deposited in the Highway Trust Fund and 0.1 cent per gallon is deposited in the Leaking Underground Storage Tank (LUST) Trust Fund. In the case of gasohol, which is taxed at a reduced rate, 2.5 cents per gallon is retained in the General Fund of the Treasury, 0.1 cent per gallon is deposited in the LUST Trust Fund, and the balance of the reduced rate is deposited in the Highway Trust Fund. The Administration believes that it is appropriate that the entire amount of the excise tax on gasohol (except for the 0.1 cent per gallon deposited in the LUST Trust Fund) be deposited in the Highway Trust Fund. Effective for collections after September 30, 2003, the Administration proposes to transfer the 2.5 cents per gallon of the gasohol excise tax that is currently retained in the General Fund of the Treasury to the Highway Trust Fund.

Increase Indian gaming activity fees.—The National Indian Gaming Commission regulates and monitors gaming operations conducted on Indian lands. Since 1998, the Commission has been prohibited from collecting more than $8 million in annual fees from gaming operations to cover the costs of its oversight responsibilities. The Administration proposes to amend the current fee structure so that the Commission can adjust its activities to the growth in the Indian gaming industry.

SIMPLIFY THE TAX LAWS

Establish uniform definition of a qualifying child.—The tax code provides assistance to families with children through the dependent exemption, head-of-household filing status, child tax credit, child and dependent care tax credit, and earned income tax credit (EITC). However, because each provision defines an eligible "child" differently, taxpayers must wade through pages of bewildering rules and instructions, resulting in confusion and error. The Administration proposes to harmonize the definition of qualifying child across these five related tax benefits, thereby reducing both compliance and administrative costs. Under the Administration's proposal, a qualifying child must meet the following three tests: (1) Relationship—The child must be the taxpayer's biological or adopted child, stepchild, sibling, or step-sibling, a descendant of one of these individuals, or a foster child. (2) Residence—The child must live with the taxpayer in the same principal home in the United States for more than half of the year. (3) Age—The child must be under age 19, a full-time student if over 18 and under 24, or totally and permanently disabled. Neither the support nor gross income tests of current law would apply to qualifying children who meet these three tests. In addition, taxpayers would no longer be required to meet a household maintenance test when claiming the child and dependent care tax credit. Current law requirements that a child be under age 13 for the dependent care credit and under age 17 for the child tax credit, would be maintained. Taxpayers generally could continue to claim individuals who do not meet the proposed relationship, residency, or age tests as dependents if they meet the requirements under current law, and no other taxpayer claims the same individual.

Simplify adoption tax provisions.—Under current law, for taxable years beginning before January 1, 2011, the following tax benefits are provided to taxpayers who adopt children: (1) a nonrefundable tax credit for qualified expenses incurred in the adoption of a child, up to a certain limit, and (2) the exclusion from gross income of qualified adoption expenses paid or reimbursed by an employer under an adoption assistance program, up to a certain limit. Taxpayers may not claim the credit for expenses that are excluded from gross income. In 2003, the limitation on qualified adoption expenses for both the credit and the exclusion is $10,160. Taxpayers who adopt children with special needs may claim the full $10,160 credit or exclusion even if adoption expenses are less than this amount. Taxpayers may carry forward unused credit amounts for up to five years. When modified adjusted gross income exceeds $152,390 (in 2003), both the credit amount and the amount excluded from gross income are reduced pro-rata over the next $40,000 of modified adjusted gross income. The maximum credit and exclusion and the income at which the phase-out range begins are indexed annually for inflation. For taxable years beginning after December 31, 2010, taxpayers will be able to claim the credit only if they incur expenses for the adoption of children with special needs. For these taxpayers the qualified expense limit will be $6,000, the credit will be reduced pro-rata between $75,000 and $115,000 of modified adjusted gross income, and the credit amount and phase-out range will not be indexed annually for inflation. Taxpayers may not exclude employer-provided adoption assistance from gross income for taxable years beginning after December 31, 2010.

To reduce marginal tax rates and simplify computations of tax liabilities, the Administration is proposing to eliminate the income phaseout of the adoption tax credit and exclusion. The proposal would be effective for taxable years beginning after December 31, 2002. The broader eligibility criteria, larger qualifying expense limitations, and the employer exclusion would apply in taxable years beginning after December 31, 2010 as a result of the Administration's proposal to extend the EGTRRA provisions permanently.

Expand tax-free savings opportunities.—Under current law, individuals can contribute to traditional

IRAs, nondeductible IRAs, and Roth IRAs, each subject to different sets of rules. For example, contributions to traditional IRAs are deductible, while distributions are taxed; contributions to Roth IRAs are taxed, but distributions are excluded from income. In addition, eligibility to contribute is subject to various age and income limits. While primarily intended for retirement saving, withdrawals for certain education, medical, and other non-retirement expenses are penalty free. The eligibility and withdrawal restrictions for these accounts complicate compliance and limit incentives to save.

The Administration proposes to replace current law IRAs with two new savings accounts: a Lifetime Savings Accounts (LSA) and a Retirement Savings Account (RSA). Regardless of age or income, individuals could make annual nondeductible contributions of $7,500 to an LSA and $7,500 (or earnings if less) to an RSA. Distributions from an LSA would be excluded from income and, unlike current law, could be made at anytime for any purpose without restriction. Distributions from an RSA would be excluded from income after attaining age 58 or in the event of death or disability. All other distributions would be included in income (to the extent they exceed basis) and subject to an additional tax. Distributions would be deemed to come from basis first. The proposal would be effective for contributions made after December 31, 2002 and future year contribution limits would be indexed for inflation.

Existing Roth IRAs would be renamed RSAs and would be subject to the new rules for RSAs. Existing traditional and nondeductible IRAs could be converted into an RSA by including the conversion amount (excluding basis) in gross income, similar to a current-law Roth conversion. However, no income limit would apply to the ability to convert. Taxpayers who convert IRAs to RSAs could spread the included conversion amount over several years. Existing traditional or nondeductible IRAs that are not converted to RSAs could not accept any new contributions. New traditional IRAs could be created to accommodate rollovers from employer plans, but they could not accept any new individual contributions. Individuals wishing to roll an amount directly from an employer plan to an RSA could do so by including the rollover amount (excluding basis) in gross income (i.e., "converting" the rollover, similar to a current law Roth conversion).

Consolidate employer-based savings accounts.— Current law provides multiple types of tax-preferred employer-based savings accounts to encourage savings for retirement. The accounts have similar goals but are subject to different sets of rules regulating eligibility, contribution limits, tax treatment, and withdrawal restrictions. For example, 401(k) plans for private employers, SIMPLE 401(k) plans for small employers, 403(b) plans for 501(c)(3) organizations and public schools, and 457 plans for State and local governments are all subject to different rules. To qualify for tax benefits, plans must satisfy multiple requirements. Among the requirements, the plan may not discriminate in favor of highly compensated employees (HCEs) with regard either to coverage or to amount or availability of contributions or benefits. Rules covering employer-based savings accounts are among the lengthiest and most complicated sections of the tax code and associated regulations. This complexity imposes substantial costs on employers, participants, and the government, and likely has inhibited the adoption of retirement plans by employers, especially small employers.

The Administration proposes to consolidate 401(k), SIMPLE 401(k), 403(b), and 457 plans, as well as SIMPLE IRAs and SARSEPs, into a single type of plan— Employee Retirement Savings Accounts (ERSAs)—that would be available to all employers. Defined-contribution plan qualification rules would be simplified, while maintaining their intent. In particular, top-heavy rules would be repealed and ERSA non-discrimination rules would be simplified and include a new ERSA non-discrimination safe-harbor. For example, under one of the safe-harbor options, a plan would satisfy the non-discrimination rules if it provided a 50-percent match on elective contributions up to six percent of compensation. By creating a simplified and uniform set of rules, the proposal would substantially reduce complexity. The proposal would be effective for taxable years beginning after December 31, 2003.

EXPIRING PROVISIONS

Temporarily Extend Expiring Provisions

Extend and modify the work opportunity tax credit and the welfare-to-work tax credit.—Under present law, the work opportunity tax credit provides incentives for hiring individuals from certain targeted groups. The credit generally applies to the first $6,000 of wages paid to several categories of economically disadvantaged or handicapped workers. The credit rate is 25 percent of qualified wages for employment of at least 120 hours but less than 400 hours and 40 percent for employment of 400 or more hours. The credit is available for a qualified individual who begins work before January 1, 2004.

Under present law, the welfare-to-work tax credit provides an incentive for hiring certain recipients of long-term family assistance. The credit is 35 percent of up to $10,000 of eligible wages in the first year of employment and 50 percent of wages up to $10,000 in the second year of employment. Eligible wages include cash wages plus the cash value of certain employer-paid health, dependent care, and educational fringe benefits. The minimum employment period that employees must work before employers can claim the credit is 400 hours. This credit is available for qualified individuals who begin work before January 1, 2004.

The Administration proposes to simplify employment incentives by combining the credits into one credit and making the rules for computing the combined credit simpler. The credits would be combined by creating a new welfare-to-work targeted group under the work opportunity tax credit. The minimum employment periods and credit rates for the first year of employment under the present work opportunity tax credit would apply to welfare-to-work employees. The maximum amount of eligible wages would continue to be $10,000 for welfare-to-work employees and $6,000 for other targeted groups. In addition, the second year 50-percent credit currently available under the welfare-to-work credit would continue to be available for welfare-to-work employees under the modified work opportunity tax credit. Qualified wages would be limited to cash wages. The work opportunity tax credit would also be simplified by eliminating the need to determine family income for qualifying ex-felons (one of the present targeted groups). The modified work opportunity tax credit would apply to individuals who begin work after December 31, 2003 and before January 1, 2006.

Extend minimum tax relief for individuals.—A temporary provision of current law permits nonrefundable personal tax credits to offset both the regular tax and the alternative minimum tax, for taxable years beginning before January 1, 2004. The Administration is concerned that the AMT may limit the benefit of personal tax credits and impose financial and compliance burdens on taxpayers who have few, if any, tax preference items and who were not the originally intended targets of the AMT. The Administration proposes to extend minimum tax relief for nonrefundable personal credits for two years, to apply to taxable years 2004 and 2005. The proposed extension does not apply to the child credit, the earned income credit or the adoption credit, which were provided AMT relief through December 31, 2010 under the Economic Growth and Tax Relief Reconciliation Act of 2001. The refundable portion of the child credit and the earned income tax credit are also allowed against the AMT through December 31, 2010.

A temporary provision of current law increased the AMT exemption amounts to $35,750 for single taxpayers, $49,000 for married taxpayers filing a joint return and surviving spouses, and $24,500 for married taxpayers filing a separate return and estates and trusts. Effective for taxable years beginning after December 31, 2004, the AMT exemption amounts will decline to $33,750 for single taxpayers, $45,000 for married taxpayers filing a joint return and surviving spouses, and $22,500 for married taxpayers filing a separate return and estates and trusts. The Administration proposes to extend the temporary, higher exemption amounts through taxable year 2005.

Extend the District of Columbia (DC) Enterprise Zone.—The DC Enterprise Zone includes the DC Enterprise Community and District of Columbia census tracts with a poverty rate of at least 20 percent. Businesses in the zone are eligible for: (1) a wage credit equal to 20 percent of the first $15,000 in annual wages paid to qualified employees who reside within the District of Columbia; (2) $35,000 in increased section 179 expensing; and (3) in certain circumstances, tax-exempt bond financing. In addition, a capital gains exclusion is allowed for certain investments held more than five years and made within the DC Zone, or within any District of Columbia census tract with a poverty rate of at least 10 percent. The DC Zone incentives apply for the period from January 1, 1998 through December 31, 2003. The Administration proposes to extend the DC Zone incentives for two years, making the incentives applicable through December 31, 2005.

Extend the first-time homebuyer credit for the District of Columbia.—A one-time, nonrefundable $5,000 credit is available to purchasers of a principal residence in the District of Columbia who have not owned a residence in the District during the year preceding the purchase. The credit phases out for taxpayers with modified adjusted gross income between $70,000 and $90,000 ($110,000 and $130,000 for joint returns). The credit does not apply to purchases after December 31, 2003. The Administration proposes to extend the credit for two years, making the credit available with respect to purchases after December 31, 2003 and before January 1, 2006.

Extend authority to issue Qualified Zone Academy Bonds.—Current law allows State and local governments to issue "qualified zone academy bonds," the interest on which is effectively paid by the Federal government in the form of an annual income tax credit. The proceeds of the bonds have to be used for teacher training, purchases of equipment, curriculum development, or rehabilitation and repairs at certain public school facilities. A nationwide total of $400 million of qualified zone academy bonds were authorized to be issued in each of calendar years 1998 through 2003. In addition, unused authority arising in 1998 and 1999 can be carried forward for up to three years and unused authority arising in 2000 through 2003 can be carried forward for up to two years. The Administration proposes to authorize the issuance of an additional $400 million of qualified zone academy bonds in each of calendar years 2004 and 2005; unused authority could be carried forward for up to two years. Reporting of issuance would be required.

Extend deduction for corporate donations of computer technology.—The charitable contribution deduction that may be claimed by corporations for donations of inventory property generally is limited to the lesser of fair market value or the corporation's basis in the property. However, corporations are provided augmented deductions, not subject to this limitation, for certain contributions. Under current law, an augmented deduction is provided for contributions of computer technology and equipment to public libraries and to U.S. schools for educational purposes in grades K-12. The Administration proposes to extend the deduction, which expires with respect to donations made after December 31, 2003, to apply to donations made before January 1, 2006.

Allow net operating losses to offset 100 percent of alternative minimum taxable income.—Under current law (and under law in effect prior to 2001) net operating loss (NOL) deductions cannot reduce a taxpayer's alternative minimum taxable income (AMTI) by more than 90 percent. Under JCWAA this limitation was temporarily waived. The Administration's proposal would extend this waiver through 2005. NOL carrybacks arising in taxable years ending in 2003, 2004, and 2005, or carryforwards to these years, would offset 100 percent of a taxpayer's AMTI.

Extend IRS user fees.—The Administration proposes to extend for two years, through September 30, 2005, IRS authority to charge fees for written responses to questions from individuals, corporations, and organizations related to their tax status or the effects of particular transactions for tax purposes. Under current law, these fees are scheduled to expire effective with requests made after September 30, 2003.

Extend abandoned mine reclamation fees.—Collections from abandoned mine reclamation fees are allocated to States for reclamation grants. Current fees of 35 cents per ton for surface mined coal, 15 cents per ton for underground mined coal, and 10 cents per ton for lignite coal are scheduled to expire on September 30, 2004. Abandoned land problems are expected to exist in certain States after all the money from the collection of fees under current law is expended. The Administration proposes to extend these fees until the most significant abandoned mine land problems are fixed. The Administration also proposes to modify the authorization language to allocate more of the receipts collected toward restoration of abandoned coal mine land.

Permanently Extend Expiring Provisions

Permanently extend provisions expiring in 2010.—Most of the provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 sunset on December 31, 2010. The Administration proposes to permanently extend these provisions.

Permanently extend the research and experimentation (R&E) tax credit.—The Administration proposes to permanently extend the 20-percent tax credit for qualified research and experimentation expenditures above a base amount and the alternative incremental credit, which are scheduled to expire on June 30, 2004.

Repeal the disallowance of certain deductions of mutual life insurance companies.—Life insurance companies may generally deduct policyholder dividends, while dividends to stockholders are not deductible. Section 809 of the Internal Revenue Code attempts to identify amounts returned by mutual life insurance companies to holders of participating policies in their role as owners of the company, and generally disallows a deduction for mutual company policyholder dividends (or otherwise increases taxable income by reducing the amount of end-of-year reserves) in an amount equal to the amount identified under section 809. The section 809 imputed amount is termed the company's differential earnings amount, and equals the product of the individual company's average equity base and an industry-wide computed differential earnings rate. The average equity base is computed using the company's surplus and capital, adjusted for non-admitted financial assets, the excess of statutory reserves over tax reserves, certain other reserves, and by 50 percent of the provision for policyholder dividends payable in the following year. The differential earnings rate equals the excess of an imputed stock earnings rate (the average stock earnings rate for the prior three years of the 50 largest domestic stock life insurance companies, adjusted by a factor roughly equal to 0.90555) over the average earnings rate of all domestic mutual life insurance companies. The differential earnings rate equals zero if the average mutual earnings rate exceeds the imputed stock earnings rate. The differential earnings rate is initially computed using the average mutual earnings rate for the second year preceding the current taxable year, but is later recomputed using the current year's average mutual earnings rate. Any difference between the differential earnings amount and the recomputed differential earnings amount is taken into account in computing taxable income for the following taxable year. Section 809 has been criticized as being theoretically unsound, overly complex, inaccurate in its measurement of income, unfair, and increasingly irrelevant. The Job Creation and Worker Assistance Act of 2002 suspended the operation of section 809 for three years, 2001 through 2003. The Administration proposes to permanently repeal section 809.

RESPOND TO FOREIGN SALES CORPORATION/EXTRATERRITORIAL INCOME DECISIONS

World Trade Organization (WTO) panels have ruled that the extraterritorial income (ETI) exclusion provisions and the foreign sales corporation (FSC) provisions constitute prohibited export subsidies under the WTO rules. To comply with the WTO ruling and honor the United States' WTO obligations, the current-law ETI provisions would be repealed. At the same time, meaningful changes to our tax law are required to preserve the competitiveness of U.S. businesses operating in the global marketplace. The Administration is proposing reform of the U.S. international tax rules, with a particular focus on reforming those aspects of the current-law rules that can operate to tax active forms of business income earned abroad before it has been repatriated and that can operate to limit the use of the foreign tax credit in a manner that causes the double taxation of income earned abroad. The Administration intends to work closely with the Congress to reform the U.S. international tax rules to ensure the competitiveness of American workers and businesses.

Table 4–3. EFFECT OF PROPOSALS ON RECEIPTS

(In millions of dollars)

	Estimate							
	2003	2004	2005	2006	2007	2008	2004–2008	2004–2013
Economic Growth Package:								
Accelerate 10-percent individual income tax rate bracket expansion	–978	–7,782	–6,112	–6,117	–6,495	–4,275	–30,781	–47,194
Accelerate reduction in individual income tax rates	–5,808	–35,693	–17,470	–4,939	....	....	–58,102	–58,102
Accelerate marriage penalty relief	–2,776	–27,134	–14,680	–7,642	–3,595	–1,735	–54,786	–55,210
Accelerate increase in child tax credit [1]	–13,527	–5,060	–10,735	–8,534	–8,532	–8,502	–41,363	–53,306
Eliminate the double taxation of corporate earnings	–3,801	–24,874	–22,062	–28,218	–31,126	–33,952	–140,232	–360,324
Increase expensing for small business	–1,023	–1,652	–1,776	–1,912	–1,601	–1,431	–8,372	–14,583
Provide minimum tax relief to individuals	–3,141	–8,534	–10,353	–6,931	....	....	–25,818	–25,818
Total economic growth package	**–31,054**	**–110,729**	**–83,188**	**–64,293**	**–51,349**	**–49,895**	**–359,454**	**–614,537**
Tax Incentives:								
Provide incentives for charitable giving:								
Provide charitable contribution deduction for nonitemizers	–199	–1,358	–1,067	–1,128	–1,177	–1,214	–5,944	–12,571
Permit tax-free withdrawals from IRAs for charitable contributions	–66	–437	–361	–376	–382	–388	–1,944	–4,076
Expand and increase the enhanced charitable deduction for contributions of food inventory	–19	–54	–59	–66	–72	–79	–330	–872
Reform excise tax based on investment income of private foundations	–16	–264	–172	–178	–186	–198	–998	–2,192
Modify tax on unrelated business taxable income of charitable remainder trusts	–1	–3	–4	–4	–4	–4	–19	–51
Modify basis adjustment to stock of S corporations contributing appreciated property	....	–12	–11	–14	–16	–19	–72	–216
Repeal the $150 million limitation on qualified 501(c)(3) bonds	–2	–6	–9	–10	–9	–9	–43	–82
Repeal restrictions on the use of qualified 501(c)(3) bonds for residential rental property	....	–2	–6	–11	–17	–24	–60	–276
Strengthen and reform education:								
Provide refundable tax credit for certain costs of attending a different school for pupils assigned to failing public schools [2]	....	–13	–29	–38	–42	–46	–168	–192
Extend, increase and expand the above-the-line deduction for qualified out-of-pocket classroom expenses	....	–23	–229	–240	–249	–260	–1,001	–2,352
Invest in health care:								
Provide refundable tax credit for the purchase of health insurance [3]	....	–324	–1,449	–889	–409	–139	–3,210	–1,550
Provide an above-the-line deduction for long-term care insurance premiums	....	–112	–559	–984	–1,923	–3,063	–6,641	–28,255
Allow up to $500 in unused benefits in a health flexible spending arrangement to be carried forward to the next year	....	–367	–640	–723	–782	–830	–3,342	–8,385
Provide additional choice with regard to unused benefits in a health flexible spending arrangement	....	–19	–33	–39	–45	–52	–188	–595
Permanently extend and reform Archer MSAs	....	–26	–284	–432	–486	–549	–1,777	–5,134
Provide an additional personal exemption to home caregivers of family members	....	–70	–465	–437	–422	–417	–1,811	–3,892
Allow the orphan drug tax credit for certain pre-designation expenses	....	....	....	–1	–1	–1	–3	–8
Encourage telecommuting:								
Exclude from income the value of employer-provided computers, software and peripherals	....	–35	–51	–53	–54	–56	–249	–554
Increase housing opportunities:								
Provide tax credit for developers of affordable single-family housing	....	–7	–78	–315	–750	–1,316	–2,466	–16,133

Table 4–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(In millions of dollars)

	2003	Estimate 2004	2005	2006	2007	2008	2004–2008	2004–2013
Encourage saving:								
Establish Individual Development Accounts (IDAs)	....	....	–124	–267	–319	–300	–1,010	–1,347
Protect the environment:								
Permanently extend expensing of brownfields remediation costs	....	–185	–282	–268	–257	–248	–1,240	–2,356
Exclude 50 percent of gains from the sale of property for conservation purposes	....	–21	–44	–46	–48	–50	–209	–531
Increase energy production and promote energy conservation:								
Extend and modify the tax credit for producing electricity from certain sources	–124	–264	–355	–209	–90	–92	–1,010	–1,492
Provide tax credit for residential solar energy systems	–4	–7	–10	–18	–25	–11	–71	–71
Modify treatment of nuclear decommissioning funds	–14	–251	–180	–191	–201	–212	–1,035	–2,260
Provide tax credit for purchase of certain hybrid and fuel cell vehicles	–44	–154	–316	–524	–793	–631	–2,418	–3,202
Provide tax credit for energy produced from landfill gas	–5	–28	–65	–88	–99	–112	–392	–707
Provide tax credit for combined heat and power property	–45	–71	–66	–64	–77	–14	–292	–250
Provide excise tax exemption (credit) for ethanol [4]	....	....	....	....	....	....	....	....
Promote trade:								
Implement free trade agreements with Chile and Singapore [5]	....	–25	–51	–68	–80	–92	–316	–913
Improve tax administration:								
Implement IRS administrative reforms	....	78	54	56	57	59	304	624
Permit private collection agencies to engage in specific, limited activities to support IRS collection efforts	....	46	128	111	94	97	476	1,008
Combat abusive tax avoidance transactions	12	45	83	98	99	103	428	1,007
Limit related party interest deductions	10	104	190	239	293	351	1,177	3,987
Reform unemployment insurance:								
Reform unemployment insurance administrative financing [5]	....	....	–1,068	–1,439	–3,368	–2,016	–7,891	–13,401
Total tax incentives	**–517**	**–3,865**	**–7,612**	**–8,616**	**–11,840**	**–11,832**	**–43,765**	**–107,290**
Other Proposals:								
Deposit full amount of excise tax imposed on gasohol in the Highway Trust Fund [5]	....	....	....	558	576	590	1,724	4,912
Increase Indian gaming activity fees	....	....	3	4	4	5	16	41
Total other proposals	....	....	**3**	**562**	**580**	**595**	**1,740**	**4,953**
Simplify the Tax Laws:								
Establish uniform definition of a qualifying child	–2	–43	–23	–24	–28	–19	–137	–211
Simplify adoption tax provisions	–4	–36	–37	–39	–40	–42	–194	–429
Expand tax-free savings opportunities	1,390	10,572	4,803	1,915	–648	–1,822	14,820	2,002
Consolidate employer-based savings accounts	–5	–185	–253	–263	–276	–292	–1,269	–3,011
Total simplify the tax laws	**1,379**	**10,308**	**4,490**	**1,589**	**–992**	**–2,175**	**13,220**	**–1,649**
Expiring Provisions:								
Temporarily extend expiring provisions:								
Combined work opportunity/welfare-to-work tax credit	....	–54	–201	–268	–181	–96	–800	–873
Minimum tax relief for individuals	....	–260	–7,286	–10,343	....	....	–17,889	–17,889
DC tax incentives	....	–53	–116	–58	–1	–4	–232	–357
Authority to issue Qualified Zone Academy Bonds	....	–6	–18	–34	–52	–64	–174	–514
Deduction for corporate donations of computer technology	....	–74	–127	–52	....	....	–253	–253
Net operating loss offset of 100 percent of AMTI	–639	–3,028	–2,274	–1,442	420	367	–5,957	–4,890
IRS user fees	....	68	81	6	....	....	155	155
Abandoned mine reclamation fees	....	....	308	313	319	325	1,265	2,978
Permanently extend expiring provisions:								
Provisions expiring in 2010:								
Marginal individual income tax rate reductions	....	....	....	....	....	....	....	–286,952
Child tax credit [6]	....	....	....	....	....	....	....	–46,893
Marriage penalty relief [7]	....	....	....	....	....	....	....	–20,654
Education incentives	–2	–11	–19	–27	–33	–42	–132	–4,685
Repeal of estate and generation-skipping transfer taxes, and modification of gift taxes	46	–292	–810	–1,319	–1,540	–1,736	–5,697	–125,991
Modifications of IRAs and pension plans	....	....	....	....	....	....	....	–11,236
Other incentives for families and children	....	....	....	....	....	....	....	–2,029
Other provisions:								
Research and experimentation (R&E) tax credit	....	–1,005	–3,278	–5,187	–6,291	–7,129	–22,890	–67,922

Table 4–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(In millions of dollars)

	Estimate							
	2003	2004	2005	2006	2007	2008	2004–2008	2004–2013
Suspension of disallowance of certain deductions of mutual life insurance companies	....	–123	–137	–65	–36	–24	–385	–472
Total expiring provisions	**–595**	**–4,838**	**–13,877**	**–18,476**	**–7,395**	**–8,403**	**–52,989**	**–588,477**
Total effect of proposals	**–30,787**	**–109,124**	**–100,184**	**–89,234**	**–70,996**	**–71,710**	**–441,248**	**–1,307,000**

[1] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $300 million for 2003, $1,074 million for 2004, $4,783 million for 2005, $4,272 million for 2006, $4,195 million for 2007, $4,142 million for 2008, $18,466 million for 2004–2008, and $25,239 million for 2004–2013.

[2] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $213 million for 2004, $543 million for 2005, $714 million for 2006, $796 million for 2007, $886 million for 2008, $3,152 million for 2004–2008, and $3,626 million for 2004–2013.

[3] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $3,546 million for 2005, $8,166 million for 2006, $9,251 million for 2007, $9,827 million for 2008, $30,790 million for 2004–2008, and $87,608 million for 2004–2013.

[4] Policy proposal with a receipt effect of zero.

[5] Net of income offsets.

[6] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $20,781 million for 2004–2013.

[7] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $3,744 million for 2004–2013.

Table 4–4. RECEIPTS BY SOURCE

(In millions of dollars)

Source	2002 Actual	Estimate					
		2003	2004	2005	2006	2007	2008
Individual income taxes (federal funds):							
Existing law	858,345	877,211	953,641	1,028,720	1,094,670	1,162,565	1,235,568
Proposed Legislation (PAYGO)	....	–28,158	–103,761	–94,164	–80,615	–59,204	–60,220
Total individual income taxes	**858,345**	**849,053**	**849,880**	**934,556**	**1,014,055**	**1,103,361**	**1,175,348**
Corporation income taxes:							
Federal funds:							
Existing law	148,037	145,799	173,659	233,213	240,064	244,618	252,020
Proposed Legislation (PAYGO)	....	–2,613	–4,599	–3,895	–6,243	–6,859	–8,336
Total Federal funds corporation income taxes	148,037	143,186	169,060	229,318	233,821	237,759	243,684
Trust funds:							
Hazardous substance superfund	7	....	....	....	....	....	....
Total corporation income taxes	**148,044**	**143,186**	**169,060**	**229,318**	**233,821**	**237,759**	**243,684**
Social insurance and retirement receipts (trust funds):							
Employment and general retirement:							
Old-age and survivors insurance (Off-budget)	440,541	454,405	475,436	503,931	525,531	550,896	575,470
Disability insurance (Off-budget)	74,780	77,160	80,732	85,572	89,241	93,548	97,722
Hospital insurance	149,049	152,275	159,784	170,037	177,525	186,262	194,827
Railroad retirement:							
Social Security equivalent account	1,652	1,643	1,674	1,695	1,718	1,730	1,750
Rail pension and supplemental annuity	2,525	2,349	2,237	2,228	2,259	2,279	2,303
Total employment and general retirement	668,547	687,832	719,863	763,463	796,274	834,715	872,072
On-budget	153,226	156,267	163,695	173,960	181,502	190,271	198,880
Off-budget	515,321	531,565	556,168	589,503	614,772	644,444	673,192
Unemployment insurance:							
Deposits by States [1]	20,911	27,312	33,195	37,076	39,002	40,078	41,146
Proposed Legislation (PAYGO)	....	....	....	....	....	–563	–234
Federal unemployment receipts [1]	6,613	6,777	6,872	7,212	7,849	8,560	7,182
Proposed Legislation (PAYGO)	....	....	....	–1,336	–1,800	–3,650	–2,288
Railroad unemployment receipts [1]	95	141	139	119	119	115	106
Total unemployment insurance	27,619	34,230	40,206	43,071	45,170	44,540	45,912
Other retirement:							
Federal employees' retirement—employee share	4,533	4,479	4,433	4,314	4,277	4,264	4,218
Non-Federal employees retirement [2]	61	52	46	42	39	36	33
Total other retirement	4,594	4,531	4,479	4,356	4,316	4,300	4,251
Total social insurance and retirement receipts	**700,760**	**726,593**	**764,548**	**810,890**	**845,760**	**883,555**	**922,235**
On-budget	185,439	195,028	208,380	221,387	230,988	239,111	249,043
Off-budget	515,321	531,565	556,168	589,503	614,772	644,444	673,192
Excise taxes:							
Federal funds:							
Alcohol taxes	7,764	7,840	7,979	8,087	8,168	8,262	8,384
Proposed Legislation (PAYGO)	....	....	–57	–78	–19	....	....
Tobacco taxes	8,274	8,158	8,015	7,923	7,824	7,725	7,633
Transportation fuels tax	814	869	939	1,009	290	293	296
Proposed Legislation (PAYGO)	....	....	–643	–711	....	....	....
Telephone and teletype services	5,829	6,205	6,611	7,002	7,408	7,827	8,265
Other Federal fund excise taxes	1,336	1,815	1,745	1,770	1,822	1,880	1,948
Proposed Legislation (PAYGO)	....	–16	–207	–94	–159	–186	–198
Total Federal fund excise taxes	24,017	24,871	24,382	24,908	25,334	25,801	26,328
Trust funds:							
Highway	32,603	32,815	34,269	35,337	36,524	37,586	38,568

Table 4–4. RECEIPTS BY SOURCE—Continued

(In millions of dollars)

Source	2002 Actual	Estimate					
		2003	2004	2005	2006	2007	2008
Proposed Legislation (PAYGO)	....	....	643	698	717	724	720
Airport and airway	9,031	9,381	10,218	10,910	11,537	12,157	12,803
Aquatic resources	386	393	417	430	441	452	464
Black lung disability insurance	567	561	574	603	622	634	648
Inland waterway	95	88	89	90	91	91	92
Vaccine injury compensation	109	124	124	126	127	129	130
Leaking underground storage tank	181	183	189	194	198	204	207
Proposed Legislation (PAYGO)	....	....	....	....	....	....	–1
Total trust funds excise taxes	42,972	43,545	46,523	48,388	50,257	51,977	53,631
Total excise taxes	**66,989**	**68,416**	**70,905**	**73,296**	**75,591**	**77,778**	**79,959**
Estate and gift taxes:							
Federal funds	26,507	20,209	23,913	22,025	24,561	22,226	22,525
Proposed Legislation (PAYGO)	....	....	–534	–927	–1,347	–1,474	–1,360
Total estate and gift taxes	**26,507**	**20,209**	**23,379**	**21,098**	**23,214**	**20,752**	**21,165**
Customs duties:							
Federal funds	17,884	18,252	19,892	20,341	22,937	25,032	26,536
Proposed Legislation (PAYGO)	....	....	–34	–69	–91	–107	–123
Trust funds	718	800	855	928	1,006	1,081	1,147
Total customs duties	**18,602**	**19,052**	**20,713**	**21,200**	**23,852**	**26,006**	**27,560**
MISCELLANEOUS RECEIPTS:[1 3]							
Miscellaneous taxes	92	95	97	99	100	102	104
Proposed Legislation (PAYGO)	....	....	....	3	4	4	5
United Mine Workers of America combined benefit fund	124	152	116	109	103	96	90
Deposit of earnings, Federal Reserve System	23,683	23,565	27,078	33,283	35,206	36,993	39,134
Defense cooperation	12	6	7	7	7	8	8
Fees for permits and regulatory and judicial services	7,280	8,359	8,720	8,495	8,590	8,763	8,737
Proposed Legislation (PAYGO)	....	....	....	308	313	319	325
Fines, penalties, and forfeitures	2,812	2,597	2,609	2,623	2,640	2,662	2,681
Gifts and contributions	246	210	200	197	198	199	198
Refunds and recoveries	–323	–275	–287	–294	–295	–303	–310
Total miscellaneous receipts	**33,926**	**34,709**	**38,540**	**44,830**	**46,866**	**48,843**	**50,972**
Adjustment for revenue uncertainty[4]	....	**–25,000**	**–15,000**	....	....	....	....
Total budget receipts	**1,853,173**	**1,836,218**	**1,922,025**	**2,135,188**	**2,263,159**	**2,398,054**	**2,520,923**
On-budget	1,337,852	1,304,653	1,365,857	1,545,685	1,648,387	1,753,610	1,847,731
Off-budget	515,321	531,565	556,168	589,503	614,772	644,444	673,192
MEMORANDUM							
Federal funds	1,108,949	1,065,477	1,112,176	1,274,830	1,366,039	1,461,380	1,543,891
Trust funds	464,990	474,018	511,003	530,431	553,840	576,262	602,856
Interfund transactions	–236,087	–234,842	–257,322	–259,576	–271,492	–284,032	–299,016
Total on-budget	**1,337,852**	**1,304,653**	**1,365,857**	**1,545,685**	**1,648,387**	**1,753,610**	**1,847,731**
Off-budget (trust funds)	**515,321**	**531,565**	**556,168**	**589,503**	**614,772**	**644,444**	**673,192**
Total	**1,853,173**	**1,836,218**	**1,922,025**	**2,135,188**	**2,263,159**	**2,398,054**	**2,520,923**

[1] Deposits by States cover the benefit part of the program. Federal unemployment receipts cover administrative costs at both the Federal and State levels. Railroad unemployment receipts cover both the benefits and adminstrative costs of the program for the railroads.

[2] Represents employer and employee contributions to the civil service retirement and disability fund for covered employees of Government-sponsored, privately owned enterprises and the District of Columbia municipal government.

[3] Includes both Federal and trust funds.

[4] These amounts reflect an additional adjustment to receipts beyond what the economic and tax models forecast and have been made in the interest of cautious and prudent forecasting.